

ARTICLE

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How Senior Executives Can Understand the Profit Potential in Pricing



Can you say in your business, “We make excellent pricing decisions and consistently price at the right level?” Most senior executives have a gut feel about their pricing. But just how big is the opportunity?

If you are a modern CFO or business unit leader, you are always on the lookout for sales or margin improvement opportunities. But you are always busy, and you know business is a juggling act of competing priorities: capacity of organization to undertake initiatives, imperatives to meet short term goals, budget constraints, etc. In addition, detailed pricing decisions are sometimes made by just a few people without broader executive understanding.

In that context, it may be too easy to skip pricing as a lever, even though pricing is one of the most powerful levers you can employ. It may be a matter of benign neglect: “After all, we price to customers every day; why fix what isn’t broken?” Or it may be “I think there’s opportunity there, but I don’t know how much and I am not sure of the right questions to ask the organization?”

We work frequently with executives that think they may have a problem, but are not sure. And while a full diagnostic can fully flesh out all the complexities (leading to efforts that result in 100-500bps of margin), even some simple probing can reveal the degree and size of the issues.

- Are our prices under control?
- Have we priced our products consistent with the value we bring to customers, relative to the competition (and how do we know)?
- How sophisticated is our pricing and our capabilities?



Is Pricing under Control?

In many ways, this may be the easiest to find out as a senior executive, as much of the data is internally-driven. It can also suggest the “size of the prize” in pricing. We would suggest looking at current trends, the pricing ranges, how rational the current pricing is, and whether the business is “leaking profit” in other ways.

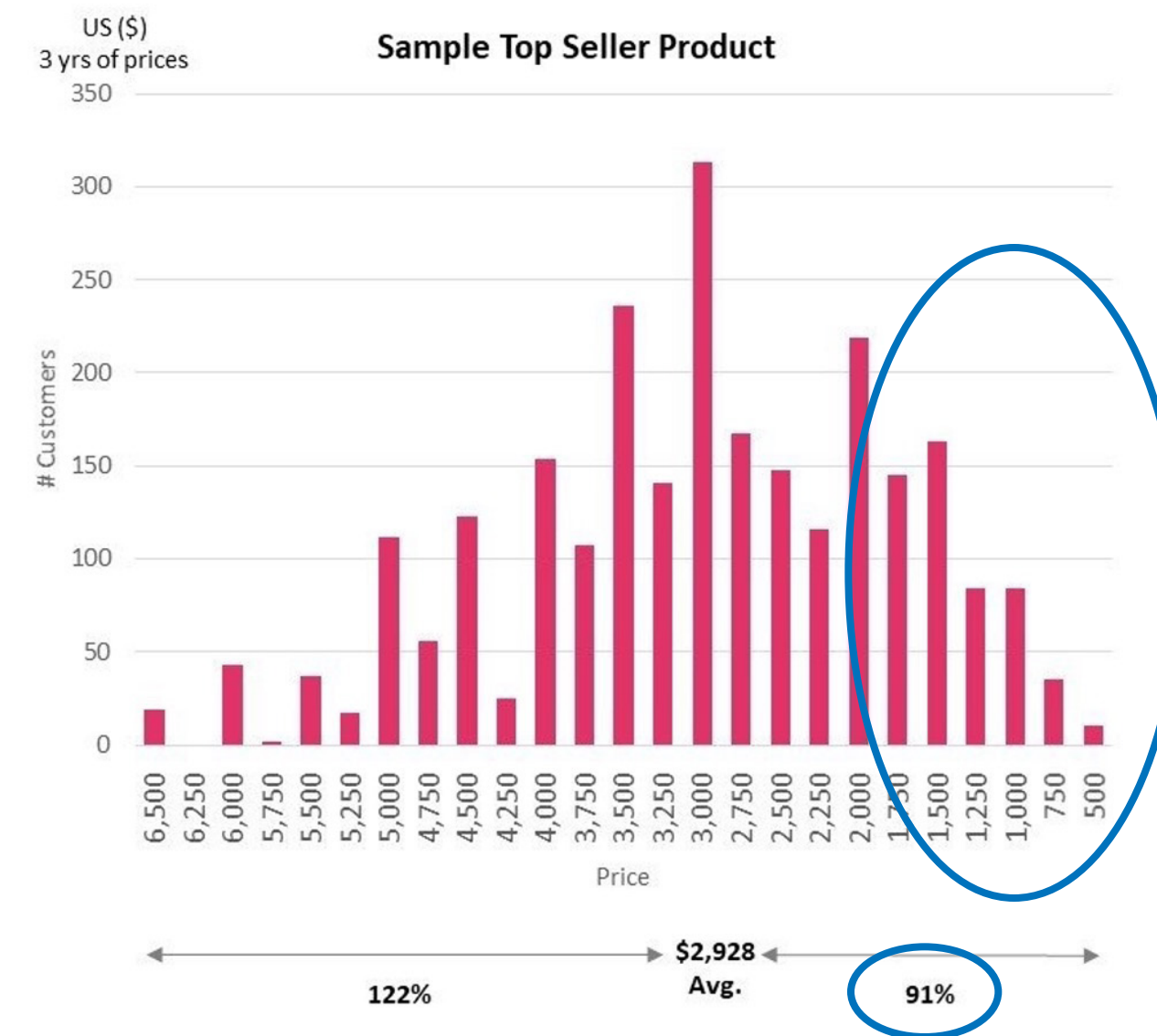
TRENDS

While bad pricing may not be the only root cause, looking at trends over time can be telling:

- Is your growth slowing?
- Are your margins slowly dropping?
- Are you getting more complaints about pricing?
- Is it much harder for the sales force to close business, and no one really knows why?

RANGE

Some executives do not realize how wide the range of prices that they are selling in the market; they only see rolled-up averages. For clients that we work with where the pricing is out-of-control, it is common that we will see price points that are $\pm 100\%$ or more from the average:



Key questions to ask the organization:

- Why is the range so broad?
- How do we know when it is low priced, that it needed to be that low?
- What's the process for approving these processes?



RATIONALITY

Sometimes the answer to the low prices is, “those are our largest customers.” If prices are out of control, that does not always happen. When the company does not have a pricing strategy and/or prices are not in control, we see that both large and small customers have wide ranging pricing, and that some of your least-valuable accounts can receive the same or better pricing than your most valuable accounts.

Key Questions

- Why does customer x (small volume) have the same prices as customer y (large volume)?
- What is our pricing strategy? Who do we want to give discounts to, and why?

LEAKAGE

“Leakage” is when there are additional discounts and giveaways beyond the basic price of the product. There are a variety of these, from customer and/or product discounts, to rebates, to invoice discounts, to free freight, to waiving other charges, to promotional discounts, to extended terms, etc. Price Waterfalls are a good way to visualize what all the discounts are, and how much of an impact they can have.

Finding all of them can be a challenge, as they can be housed in different systems, but even asking a simple question like “What was the value of all the individual discounts we gave to customer x last month?” can be informative. If you don’t get the information back quickly, it’s likely that is not tracked and may be a sign your pricing is out of control. Outside experts can quickly assess the true situation.



Have we priced our products consistent with the value we bring to customers, relative to the competition (and how do we know)?

Inherent in this question are two important aspects to a good pricing strategy: that we know the value of our products through the eyes of our customers, and the value proposition (product benefits and price) is better than alternatives.

Customer perspectives on your products are invaluable for two reasons: a) most companies overestimate the value of their products vs competitors, and b) the value the products bring may come from unexpected places. We worked with an industrial filter company that sold their products to the trucking industry. Through interviews, we discovered that the filters improved the fuel efficiency of the truck much better than competitors. It provided massive value to the customer, yet that benefit was not heavily marketed by the sales force.

Knowing the price sensitivity of the products is also important. In some cases where volumes purchased are high, there may be considerable sensitivity. In other cases, your product costs may be just a small portion of the total cost to the customer, and (assuming the quality is there and there are few alternatives), the customer may be less price-sensitive.

Knowing competitive pricing can equally important, but particularly in opaque pricing environments, can be difficult to get. The point here is ask cogent questions to the team on whether the company actually knows if the price is market-relevant.

Key questions

- How do we know we have the right prices?
- When was the last time we did customer research on pricing?
- Do we regularly benchmark our prices vs the competition?



How sophisticated is our pricing and our capabilities?

While an outside perspective can help assess where you are and where you could go, some simple observations and questions may help suggest whether there are opportunities to improve:

Key Questions:

1. Is our pricing strategy cost+, or something more sophisticated?
2. Do we determine prices at the SKU/ customer (or customer segment) level, based on value and price sensitivity?
3. Does the sales force know what the prices should be, and do they know how to negotiate well with their prospects?
4. Are our pricing processes clear and consistently applied?
5. What is the level of pricing talent within the organization?
6. Do we have sophisticated pricing tools, analytics, and software to help enable the strategy?
7. How often does the senior executive team talk about pricing?

Probing in these area – Pricing control, pricing strategy, internal pricing capabilities – is just the start. Even if you conclude that there is opportunity, nothing will change without effort. If you feel the organization cannot do it themselves (expertise, speed to value, outside perspective, capacity constraints, or other reasons), find an outside consulting firm to help.



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Our Pricing Practice provides comprehensive pricing offerings, including price assessments. We offer 3 levels of assessments based on client needs, which includes data quality assessments, pricing analysis, assessment of current pricing capabilities, processes & methods, development of quick wins for immediate financial impact, and a business case & roadmap to clarify the potential impact to the business.

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