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The price is right . . . isn't it?

By Greg Cudahy and George L. Coleman

Companies that price by instinct are more likely than ever to fall behind competitors, no matter how good their products and services are. Here are the hallmarks of businesses that are improving their performance by building a powerful pricing capability.

Until a few years ago, you could walk into any of the more than 700 stores of a well-known US consumer-goods retailer and pay the same price for the identical product. The result? That company was leaving money on the table—lots of it.

In fact, this particular retailer was simply doing what many companies do: ignoring differences between customers' willingness to pay based on demographic and geographic factors and what it costs to serve those customers. Moreover, much of the company's approach to pricing was reactive—prices were hiked or cut largely in response to what its competitors were doing. But since implementing a new pricing strategy, the retailer has increased profits by more than $30 million annually.

Today, with the help of advanced pricing strategies and supporting technologies, the same retailer actively varies prices by store using insights based on multiple factors, such as local and regional consumer preferences and price elasticity.

And it isn't alone in taking this approach. All kinds of companies across all kinds of industries are embracing new technology-enabled strategies to managing and optimizing pricing, increasing the speed at which prices are fine-tuned for particular groups of customers. Price adjustments in some industries are now made almost continuously; one large bank, for example, changes prices on hundreds of proff. Indeed, businesses that make a science and a discipline out of pricing typically outperform those that still price largely on the instincts of their merchandising and buying staff. This is especially relevant to a class of companies that are otherwise strong performers; they excel at conceiving, building and distributing products, but because they haven't yet gotten pricing right, they are not properly compensated in their markets, either in terms of profits or share price performance.

The CEO's agenda

So what do the masters of effective pricing do that others don't? For a start, they are quick to embrace data-driven modeling tools to monitor, assess and adjust prices; they can accurately and promptly analyze the impact of numerous variables on every product's optimal price.

Take, for example, the New York metro drugstore chain Duane Reade. It recently grew its baby-care revenue by 27 percent while lifting the category's gross margins by two percentage points—gains that closely followed a period in which the company was losing share in diaper sales to aggressive competitors. How did the chain pull it off? By raising prices on diapers for infants while lowering them on diapers for toddlers. It did so based on an insight the chain's pricing software found in its sales data: Parents of newborns are not as price-sensitive as parents of toddlers. Encouraged by this kind of success, Duane Reade now uses advanced pricing software to guide its price points for approximately two-thirds of the items it sells.

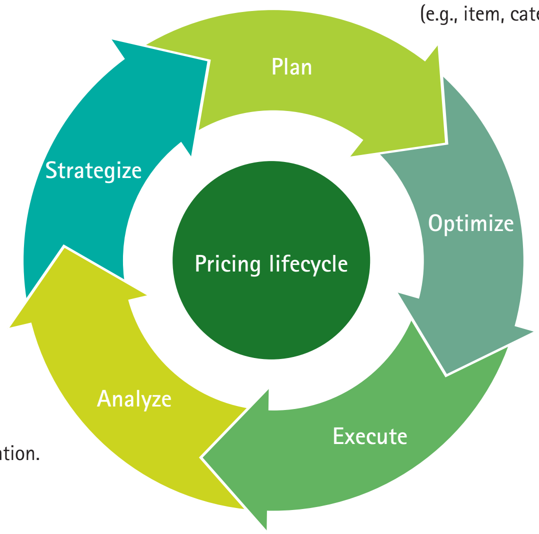
Successes like this are pushing the topic of pricing onto the agendas of more and more CEOs, who see pricing as an especially powerful lever for improving their operating margins. Research indicates that for most con-

Natural lifecycle

At the heart of a top-performing pricing organization is a holistic view of the pricing lifecycle wrapped in a closed-loop process.

Planning supports the pricing strategy by driving actionable tactics at a more granular level (e.g., item, category, competitor, customer segment, zone).

The pricing **strategy** delivers a clear vision to the stakeholders of how pricing will drive the strategic market positioning.



Price scenarios are evaluated in the **optimize** stage to identify a solution that best satisfies business rules and financial goals.

Each pricing decision is **analyzed** to garner insight and results to more effectively reach customers and drive greater market differentiation.

Defined processes, roles and responsibilities are developed to efficiently **execute** optimized prices throughout the pricing lifecycle.

Pricing lifecycle

- **Regular prices** represent the value proposition that is communicated to customers for most of the life of each product in a category.
- **Promotion prices** are the primary tool for managing category traffic with special prices. The theory is that the reduction in margin is offset by the increase in volume.
- **Markdown prices** are utilized to recoup untapped revenue on idle inventory typically at the end of the pricing lifecycle.

sumer businesses, a 1 percent increase in average prices lifts operating profits by at least 11 percent. Full pricing transfor-mations can deliver as much as an 8 percent increase in revenues; that gain falls directly to the bottom line, giving pricing changes more impact than just about any other profit-generating initiative.

Smart CEOs are recognizing they can't go it alone. Chief executives at some of the pricing leaders also have the benefit of the expertise of a chief pricing officer—a new but increasingly critical executive role. In fact, the number of pricing officers has climbed substantially since 2001, according to AMR Research.

Furthermore, top performers are driving pricing capabilities deeper into their organizations than in the past, often with the help of a centralized group of experts. With the right organization structure and the right tools, they are proving that when it comes to pricing, good data and tight discipline trump instinct every time.

From strategy to process

Of course, developing a pricing capability is not as simple as buying the right software. Powerful pricing capabilities start with a strong pricing strategy. However, while it may seem that most companies have pricing strategies, this is typically true only up to a point. Third-party research indicates that more then 50 percent of companies have some sort of pricing strategy in place—a significant number, to be sure, but still only slightly more than half. Even those that do have pricing strategies are finding that the effective life-span of these strategies, regardless of their perceived quality, is growing ever shorter.

It's not hard to see why a pricing strategy can be so perishable. First, marketplace and competitive demands are changing all the time. Product lifecycles are shrinking; many products succeed or fail in a matter of months. For instance, in consumer electronics or media products and services, the lifetime profitability of an item can depend on just the first few weeks after launch; mispricing out of the gate can destroy years of work and planning.

In addition, getting pricing right is a function of numerous factors. Companies need to understand their customers' willingness to pay and the cost to serve them at the microsegment level. These two factors are, in turn, affected by the various channels used, the packaging or format chosen, whether the product is bundled with something else, the geographic markets selected, and other promotions or discounts in place. Some of these elements change as often as several times each week. With so many variables, optimal pricing is extraordinarily difficult to comprehend, let alone execute; frequently, it means assessing and acting on millions of combinations and permutations on a daily or weekly basis.

Therefore, pricing strategy is only the beginning. Chief executives and chief operating officers who believe that a strong pricing capability is essential to the success of their business look beyond this starting point to ensure that the right mechanisms for pricing execution—particularly in terms of the requisite skills and systems—are in place. These executives recognize that a complete pricing process is needed to complement pricing strategies if their products are not to end up as shelfware. Top performers also know that pricing strategies fail when nobody in the organization can report on how they are being implemented, and when there is no way to sense how customers are responding to them. Without analytic processes to interpret the outcomes of pricing decisions—changes in profitability

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Plotting the transformation

Every company has unique challenges in creating a powerful pricing capability, stemming from the nature of its industry, the type of products and services it sells, and broader economic forces. Yet many successful pricing transformations appear to have certain elements in common. Accenture has identified six discrete activities that leading companies complete as sequential steps in their pricing transformations.

1. Run a pricing diagnostic. Implementing a diagnostic is necessary to obtain a picture of the company's current pricing capabilities, build a case for the benefits of a transformation program, start to sketch out the pricing strategy and goals, evaluate product vendors and draft a plan for overhauling the organization's pricing capabilities.

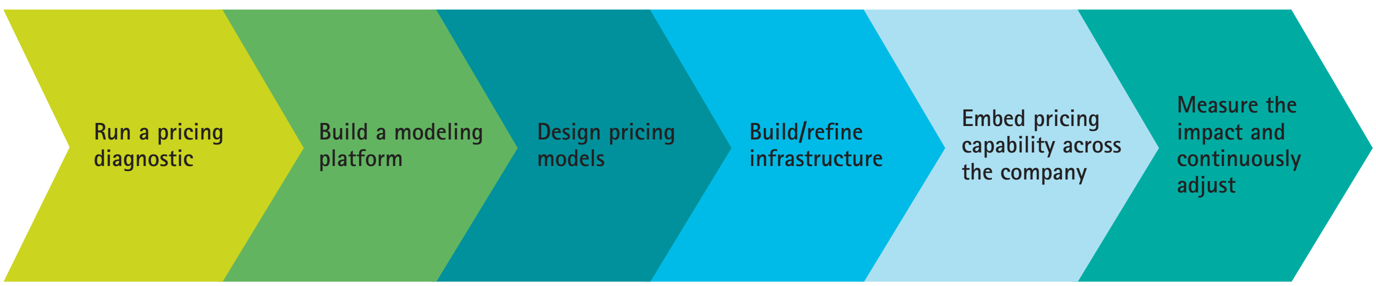
2. Build a modeling platform. At this stage, companies test initial assumptions, set investment goals and lay out a rollout plan.

3. Design pricing models. At this stage, pricing models are created and integrated into the pricing strategy, and the gaps in pricing capability are identified.

4. Build pricing infrastructure. The framework for the pricing processes is laid out and the organization design is revised, often to accommodate a dedicated pricing group. At the same time, the appropriate IT solutions are evaluated, built and tested.

5. Embed pricing capability across the company. With the foundation elements in place, the company rolls out the revised pricing program, performs the necessary due diligence on basic pricing capabilities in other parts of the organization, and trains and prepares staff.

6. Measure the impact. In this final stage of the launch, the transformation team develops the requisite scorecards and benefits assessments, fine-tunes roles and responsibilities, and sets out the guidelines for compliance with the new pricing rules with the objective of fully deploying the pricing lifecycle.



- Obtain picture of company's pricing capabilities
- Build case for benefits
- Sketch out pricing strategy and goals
- Evaluate product vendors
- Draft plan for overhauling pricing capabilities

- Test initial assumptions
- Set investment goals
- Lay out rollout plan

- Create pricing models
- Integrate models into pricing strategy
- Identify gaps in pricing capability

- Lay out framework for pricing processes
- Revise organization design to accommodate dedicated pricing group
- Evaluate, build and test appropriate IT solutions
- Execute

- Roll out revised pricing program
- Perform necessary due diligence
- Train and prepare staff

- Develop requisite scorecards and benefits assessments
- Fine-tune roles and responsibilities
- Set out guidelines for compliance with new pricing rules with objective of fully deploying pricing lifecycle

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and customer satisfaction, for example—companies are more or less flying blind.

Yet pricing is not simply about achieving high performance. Failing in the pricing arena can do more than just lower profits.

Many experts believe that the lack of a pricing capability is what eventually undid Polaroid Corporation. Critics point to the company's inability to price its digital photography products properly as a leading cause of its downfall. Poor execution in managing average selling prices may also be what has produced signs of trouble at a leading computer systems company. In 2005, the company's CEO told the media that the manufacturer could have made up much of the shortfall between actual quarterly revenues and what it had led Wall Street to expect if it had simply added $10 to $15 to the price of each of the 9.1 million machines sold during the quarter.

Lessons from the masters

By their nature, top performers are open to the idea of transforming their approaches to pricing (see sidebar, page 4). They also undertake five activities that are key components of a successful strategic pricing capability.

They recognize and manage the pricing lifecycle.
Effective pricing relies on a closed-loop process of strategizing, planning, optimizing, executing and analyzing that begins well before an item's introduction on the shelves. As part of the recent pricing transformation at a leading US consumer-goods retailer, the team responsible for the initiative crafted crisp descriptions of all of its competitors, broken down into "buckets" such as store, region and product category, to better understand the market. It also set up a discrete organizational unit to own the complete pricing lifecycle and gave plenty of attention to the design of the processes that would align stakeholders, systems and the organization structure. The approach was designed to be easily scalable.

They invest in innovative technology.
New software tools make it easier to track pricing trends, to test the likely effects of price changes and monitor the actual effects of pricing decisions, and to continuously optimize pricing decisions across products, markets, customer segments, regions, time zones and promotion periods.

While investment levels vary by industry and circumstance, Fortune 1000 companies polled by Yankee Group Research report returns on investment of up to 20 percent for price management and profit optimization software solutions. The right analytical tools allow detailed and frequent examination of customer preferences and demand patterns, and can be integrated easily into an organization's existing IT architectures.

Grocery chains have been active users of such tools for a few years now. Boise, Idaho-based Albertsons, for instance, uses a revenue management application to guide its pricing and promotion decisions in its 2,500 stores throughout the United States. According to Yankee Group Research, 77 percent of companies plan to use pricing management and profit optimization software solutions in the near future.

They set up dedicated pricing groups.
Top performers establish groups whose sole responsibility is the creation and execution of pricing strategy, including continuous reassessment and adjustment. For example, three years after losing a bruising market-share battle with a longtime rival, a leading European supermarket chain included a new center of pricing expertise in its pricing transformation. The center's tasks included running daily price

simulations and improving the skills of pricing managers.

They appoint cross-functional stakeholders.
Drawing from corporate functions and operating units, top performers appoint senior managers to a governing body that shares accountability with the pricing organization. One major international beverage company recently appointed an executive vice president for sales and distribution, who also oversees the company's pricing strategy group and its international brands development initiatives.

They create an integrated process architecture.
Top performers design a framework that clearly defines pricing responsibilities, tasks and handoffs; the goal is to infuse pricing strategy into all activities. The importance of such a framework can be seen in the case of a leading global freight company. Hamstrung by convoluted pricing processes, managers often had to "wing it," routinely pricing bids just hours before they were due. A revamped pricing strategy supported by a robust analytical tool set allowed the firm to improve its bid pricing and—just as important—its time to bid, which dropped by nearly 90 percent. The result: The sales force now can focus on customers instead of the company's internal processes.

Applied individually, each of those five activities will yield some gains . . . but the true top performers apply them all as part of a cohesive plan—and have the results to show for it. Take the US retailer described earlier that embraced individual pricing at its 700-plus stores. By deploying deep analytics, developing a centralized pricing function, and building and implementing a solid pricing strategy, the company saw returns of nearly

Portraits in contrast

Conventional pricing

- Typically not considered a strategic focus area.
- Pricing decisions are fragmented across the business, resulting in poor communication and execution.
- Planning and tactics associated with pricing are primarily driven by the competition.
- Little data available to support informed, fact-based price recommendations.
- There is a limited or no visibility into the overall effects of pricing decisions, causing past practices to be repeated.

Leading-edge pricing

- Pricing is seen as a strategic capability able to differentiate in the marketplace.
- Pricing decision support is centralized in a dedicated pricing group, with significant involvement from cross-functional groups.
- Microsegmentation based on bahaviors and pricing power.
- Highly evolved pricing strategies are supported by planning and tactics executed across demand zones.
- Data are analyzed at a granular level to generate insight into how consumer demand changes due to movements in price.
- Price change impacts are continuously monitored and measured at different levels of decision making—business unit, department, category, item—and their effect on consumers is gauged.

380 percent on its investment in project and software costs in the first year. In addition, the 48 categories rolled out to its stores to date—three-quarters of all that it sells—have each had strong growth in unit sales as well as profitability.

Changing paradigms

For too many companies, pricing is still a collection of disparate short-term activities rather than a business discipline and an embedded core competency. The good news is that pricing has moved out of the realm of academic study and is now on the action-item list for many executives in leading companies. It is also encouraging that some sectors are showing the intention to change: In 2005, 85 percent of retail companies said that improving strategic pricing will be a key objective in the next two years, according to a survey by research and events firm Retail Systems Alert Group.

Improvement cannot come too soon. Accenture's research shows that one-third of retail stores have at least 10 percent of their stock left at the end of a season—for some companies, that figure tops 25 percent. At the same time, the Internet has given consumers a potent tool for exploring costs and comparable products and thus resisting price increases on any level—seasonal or regional.

Moreover, because today's consumers are far more demanding and far less predictable, the mass-market paradigms that still guide much pricing decision making no longer apply. "Market of one" approaches have materialized in response, but the usual outcome has been further product-line complexity (the number of new SKUs introduced annually in US retail channels has nearly doubled in the past decade, to 30,000), which begets more complicated supply chains—and even tougher pricing decisions.

Already the top performers are moving toward mastery in pricing. They have chosen to treat it as a strategic discipline, with all pricing decisions driven by strategies grounded in customer insights and corporate objectives.

Concurrently, the top performers have taken many of the steps necessary to properly implement those strategies: breaking down pricing decisions by region or by customer segment; building decisions on hard data sifted through advanced software; basing optimal prices on inventory positions, available production capacity, demand forecasts and competitive market conditions; and creating "sense and respond" mechanisms that allow them to test often and react fast.

These companies can now confidently use pricing as an offensive lever. They now know the effect their pricing decisions are likely to have on customers' buying behaviors—and on financial performance, regionally or globally, short term and long term. They can plan more confidently for the future—taking more calculated risks and making fewer guesses. Ultimately, effective pricing is the best way to make the biggest difference in earnings while preserving unit sales and market share. It is, in effect, the last major step on the path to high performance.

About the authors

Greg Cudahy is the managing partner of Accenture Pricing Strategy & Profit Optimization and Accenture Supply Chain Strategy. With more than 25 years' experience, Mr. Cudahy focuses on strategy development and capability-building in support of price management, optimization and analytics, as well as total supply chain transformation by balancing supply-side capabilities with demand-shaping factors like pricing and promotion. Based in Atlanta, Mr. Cudahy has worked across a variety of industries with special emphasis on consumer goods and media/high tech. In 2005, he was named by *World Trade Magazine* as one of the Top 50 Supply Chain Pioneers.

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