Maximizing the Pricing Capability: Pricing as a Managed Service

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As companies develop more sophisticated pricing strategies and capabilities, the requirements to appropriately operationalize them have been growing in complexity. Even after deciding how to govern and administer pricing, resource limitations still serve as a barrier against fully leveraging the enhanced pricing function. It comes as no surprise that, in response, businesses are looking to transition some of the components to a managed services provider, while retaining the strategic thinking that creates competitive advantage. While it may seem like an easy decision, there are significant hurdles to overcome. Smart companies will take advantage of recent trends when deciding what and how to transfer—both to facilitate acceptance and adherence, and to realize the full value of the next-generation pricing capability.
The growing sophistication of pricing

The pricing function has grown increasingly sophisticated in the past several years. What was formerly a last bastion of "gut feel" has evolved into a more advanced, predictive science with numerous strategic approaches, analytical methods and supporting software tools available for enlistment. However, one area that companies often struggle with is the resources required to operationalize next-generation pricing capabilities and the efficacy of the underlying governance structure. Data from the Professional Pricing Society shows that less than five percent of Fortune® 500 companies even have a full-time function dedicated to pricing.¹

Few executives will argue that pricing talent is a scarce commodity, especially at the entry level. In fact, a recent job title search for pricing on CareerBuilder.com resulted in more than 22,000 hits.² This talent shortage often requires companies to organically grow their pricing resources, relying on the leadership of their new pricing organization to scope out and plan skills development.

Furthermore, the concept of an ideal pricing organization—one that incorporates the appropriate number of resources, and includes the right skills and responsibilities to fully administer the company's new level of sophistication—is difficult to attain. There are numerous factors contributing to the ideal design, such as the overarching pricing strategy, desired centralization, state of analytical capabilities, degree of technology enablement and market environment.

Beyond that, the industry in which the company operates will provide additional variables. For example, commodities manufacturers will need to account for how often their relevant market indices fluctuate, and financial services firms will need to leverage the size of their risk management department. (See Figure 1.)

Figure 1: General and specific questions by industry for pricing organization design

<table>
<thead>
<tr>
<th>Consumer Goods and Services</th>
<th>Resources</th>
<th>Communications</th>
<th>High-Tech</th>
<th>Financial Services</th>
<th>Pharmaceuticals</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>What is my pricing strategy?</td>
<td>How much central control do I have?</td>
<td>How many geographies do I compete in?</td>
<td>How many other responsibilities does my pricing team have?</td>
<td>How advanced are my analytical capabilities?</td>
<td>What is the current degree of technology enablement and data visibility?</td>
<td>How many relevant competitors do I have?</td>
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<tr>
<td>How many product brands do I manage?</td>
<td>How complex/varied is my product portfolio?</td>
<td>How much does my cost base fluctuate?</td>
<td>How different is the cost to serve each customer?</td>
<td>How empowered are my customer service reps?</td>
<td>What is the size of my risk management department?</td>
<td>How much of my revenues are from managed markets?</td>
</tr>
<tr>
<td>How often does my assortment change?</td>
<td>How many markdowns/promotions do I run?</td>
<td>How many contracts and agreements do I have with insurers?</td>
<td>How many stores and product categories do I have?</td>
<td>How many different coupons and rebates do I offer?</td>
<td>What is the size of my merchandising organization?</td>
<td>How many price zones do I have?</td>
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<tr>
<td>How many pricing options and plans do I have?</td>
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Unfortunately, the potential issues that could arise from a poorly designed pricing organization can be significant, given the critical role pricing plays both in a company’s financial health and brand image. Without the necessary structure, pricing will not support the overarching strategy; often this is due to a misapplication of new and unfamiliar analytics, or simple inertia limiting adherence to a new price setting process. In many cases, this results in an inability to capture the value that drove the decision to enhance pricing in the first place. To avoid this trap, the pricing governing organization needs to be able to quickly drive value realization from the company’s new capability, or personnel may further entrench themselves in unproductive pricing behaviors.

While any new process faces a degree of mistakes and pushback until change management takes over, these issues can be exacerbated if the pricing governing organization is overwhelmed, or unable to provide the necessary support and visibility into the data necessary to develop insights. Case in point, Accenture routinely finds aftersales pricing teams at mid-size and large companies with as few as three resources. These small teams are nonetheless responsible for pricing tens of thousands of replacement parts. It is a tall order for these teams to keep up with demand, given the large volume of parts and ever-changing market conditions.
Pricing as a managed service can help alleviate the strain

When it comes to a pricing organization, 'getting it right' has little margin for error. As the arms and legs that drive a more sophisticated pricing capability, success or failure of the new strategy, analytics, process and technology will all hinge upon this organization. Failure is a costly option, both for the company's image and bottom line.

As previously described, organizations often underestimate the required resources to properly administer and execute a next-generation pricing capability. As a result, they do not have the necessary personnel or skills in-house to address their pricing needs. Additionally, many firms do not have sophisticated tools and software to be able to optimize price setting, execute those prices in the market, and conduct back-end analytics to measure the market impact of price changes.

When facing situations like these in other functional areas, companies have found managed services to be an appealing alternative. Is this possible with pricing? The short answer is yes.

Although there are barriers to overcome for a fully externally managed pricing capability, many of the underlying, commodity-type activities can be entrusted to a strategic third party with deep pricing experience across multiple industries. Transitioning components of pricing to a nimble and specialized provider can help address the need for additional resources in the short term, and deliver substantial cost savings in the long term.

The critical success factor in terms of what and how to transition is to maintain in-house control of the strategic thinking that drives competitive advantage, such as setting pricing rules and guidelines for different segments, while giving up the reins to non-core activities that are far less defining of the company's brand, such as running and distributing reports. With these day-to-day supporting activities out of the way, companies can focus attention on capturing value from their significant investments in building the pricing function.

In some cases, a managed services provider also can provide significant input into the overall pricing function for companies, helping to increase the return from pricing. Toward this goal, the third party collects and analyzes reams of product and sales data, along with external market data, to recommend outward-facing prices. Organizations' pricing and product marketing teams review the pricing recommendations and supporting data to ultimately decide the final price. Once the pricing has been implemented, the managed services provider gathers and monitors sales data to measure the market impact of pricing changes and then recommends additional fine tuning or adjustments to the company's pricing structure.

Back in 2009, when the economic slowdown hurt revenues for Manitou, a large industrial equipment manufacturer, leadership identified opportunities to improve and recover profitability in their spare parts sales but was unable to act on it internally. Rather than using the typical cost-plus approach, Accenture Management Consulting, working hand in hand with Accenture Product Lifecycle Optimization (APLO), introduced to Manitou an innovative and industrialized approach to spare parts pricing, aligning pricing policies with customers' perception of value. With APLO recommending optimized prices for spare parts, the manufacturer was able to not only increase revenues and margins, but also improve customer satisfaction and brand loyalty.
Macro trends make managed pricing more feasible

Given the potential attractiveness of pricing as a managed service, there are still some obstacles that should be removed to take full advantage of it. For one, sophisticated pricing, as a whole, is a relatively new area of competitive advantage, compared to strategic sourcing and other advanced functions that are now seen as a necessity to do business. The cultural shift necessary for companies to feel comfortable with relinquishing even the smallest portion of the pricing function is a large hurdle and will take time.

Moreover, pricing historically has been considered a sub-segment of marketing, sales or merchandising. This perception leads to a sense of turf consciousness, even if the new pricing organization is internal. Transitioning aspects of the pricing function to a third party has the potential to cause even more pushback. Combined with the typical analytical growing pains where companies spend time questioning the reliability of their data, it will prove a challenge for the pricing managed services function to gain the necessary credibility to have a meaningful role in the business.

Fortunately, there are several indications that companies are growing more prepared to move components of the pricing function to a managed services model. For starters, the philosophical outlook for traditional marketing and sales functions is shifting. What was previously considered a pure art form in terms of creative output is evolving to a combination of art and science as businesses embrace the power of predictive analytics.

In fact, Advertising Age recently touted the emergence of a new type of marketing and sales resource. According to the magazine, “…today’s creative needs to bring left and right brain together to produce inspired and measurably effective marketing programs. This environment is fostering the development of a new breed: the ‘Analytic Creative.’” As this trend shows, the way forward is to blend the science involved in running regular, standardized analytics with the art that successful marketing and sales professionals can bring to improve results.

In addition, some forward-thinking companies have successfully transferred discrete, non-strategic components of the pricing function to managed service providers—paving the way for other companies to do so even more holistically. For example, pricing execution, in the form of having prices reflected accurately in stores or billed correctly to business customers, is an area typically riddled with errors for most companies, costing some as much as one percent of revenues each year. Quality managed services providers already are bringing a degree of accuracy and efficiency to this pricing discipline, especially when a company has advanced pricing technology in place. Retailers have been leveraging third parties to conduct this pricing task for some time now, given the number of prices retail companies have to manage in every store.

Finally, when it comes to pricing technology, the most experienced managed services providers will offer advanced pricing analytics and optimization packages in the popular software-as-a-service model, allowing organizations to effectively transfer this component of pricing. This approach is possible with almost any software or analytics package, giving companies the benefit of advanced models that are always up to date and running efficiently, without the significant cost of furnishing the personnel and analytical skill requirements.
Phased approach to pricing as a managed service

Accenture suggests a phased approach for companies seeking to convert elements of the pricing function to a managed service, both to mitigate risk and assist with change management. (See Figure 2.) As with most transitions that require a significant shift in mindset, a gradual approach is best; this slow and steady method will give the pricing managed services team time to build credibility and knowledge of the business to enhance their success.

Based on their strategic impetus, organizations can choose which of the following pricing components to transition—or take a more holistic approach, effectively completing one phase before moving to the next:

Phase 1 – Data management and reporting

Pricing data warehousing is the ideal starting point, not only because it is a traditional and safe area for managed services, but also because, by definition, data serves as the foundation for all advanced, fact-based pricing decisions. If the company trusts the third party’s data, and the simple regular, descriptive reports based on it, the managed services provider already has started the process for building credibility in other major areas.

Phase 2 – Analytics

Once a business has successfully transitioned data management, it is a logical next step to convert the analytics and manipulations that are heavily intertwined with the data. Analytics can take the form of advanced price optimization technology or custom-built algorithms, provided that the analytics are run regularly in a standardized fashion. Predictive pricing analytics can deliver incredible value, but building the capability to run them can be a very involved process, limiting a company’s ability to act on the opportunities uncovered. However, moving analytics to a managed services model will allow the company to focus on the value capture aspects, greatly assisting the change management effort, as well as generating financial benefits.

Figure 2: Roadmap for transitioning components of the pricing function
Phase 3 – Execution

The next potential component comes in the form of execution. Once prices are set or negotiated, this step helps to ensure that the company actually collects the correct amount, either in the form of setting the price on a store shelf or sending the bill to a customer. Improved accuracy and efficiency can help the company avoid lost revenues and begin the cultural shift necessary to leverage the third party for pricing components outside of data and IT. Moreover, execution capabilities often limit internal resources so there should be a minimal desire from other functions, such as sales or merchandising, to maintain control.

Phase 4 – Monitoring pricing logic and rules

Having successfully broken the barrier between IT and business processes by transitioning execution, the company can expand the managed services provider role to compiling pricing logic and rules for analytics, and to monitoring adherence. As the entity with the data and execution responsibility, the third party can track each price to see how well it compares to established guidelines and highlight where exceptions occur. Although the managed services provider may not yet take a role in determining pricing logic, it can provide a great deal of visibility into its application. This allows the business to address any outstanding negotiation opportunities.

Phase 5 – Managing pricing logic and rules

For many businesses, particularly those with a cost base that fluctuates rapidly, such as meatpackers or oil refineries, a good deal of pricing is based on formulaic rules. Having become thoroughly familiar with the company’s pricing logic both by compiling it and monitoring adherence, a managed services provider can share the load of applying these formulae to keep pricing updated. Eliminating some of this repetitive work from the internal organization allows resources to focus on critical exceptions to the rules and on capturing value.

Phase 6 – Recommendations and opportunities

Finally, having insight into data, analytics, execution and pricing rules, the managed services provider is both informed and positioned to point out opportunities for pricing improvement. Not all recommendations will prove feasible, as the business will need to balance these recommendations with strategic priorities and the nature of each customer relationship. However, having an unbiased team with in-depth, first-hand knowledge of pricing performance to identify the various opportunities can drive immense returns to a company’s bottom line and help address high value realization targets.
To mitigate risk, companies are increasingly seeking outside guidance, leveraging experienced pricing professionals to help meet pricing objectives. A carefully selected managed services provider will be specially trained in and experienced with pricing, enabling organizations to leverage the strategic provider’s experience and fresh, unbiased pricing opinions to identify actionable opportunities and improve the overall value of the internal pricing team.

For example, when a large home improvement retailer wanted to shift toward a more strategic approach to pricing, it found that its internal organization and role structure was not up to the task. Accenture helped the retailer to design and implement the proper pricing organization, linking together financial analysts, database administrators, category managers and merchandising support—and assigning all with clear roles and responsibilities.
Optimizing an organization’s pricing capability

Managed services is an attractive alternative to businesses struggling to address the resource requirements to properly operationalize their sophisticated pricing capability. Fortunately, it is also a viable one if applied to the appropriate areas through a gradual and progressive approach.

Extricating a company from the underlying and non-strategic components of pricing frees internal pricing resources to focus on the truly valuable activities that require strategic experience. The overall effect of managed services can be a significant improvement in the company’s acceptance and adherence to its advanced approach to pricing, as well as an accelerated schedule to more quickly generate the returns initially promised by a next-generation pricing capability.

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