

HOW TO BUILD PRICING MUSCLE

Gain power in your pricing function through leading edge data analysis



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Introduction

What intelligence forms the base of your company's pricing structure? If yours is like most companies, price intelligence is based on your own historical transaction data. Information from past transactions is certainly important for setting pricing strategy. But it is only one part of the factors that contribute to the pricing picture. External intelligence including transactional data from competitors, customer-based information, and overall market trends must also be analyzed.

Unless external sources are included in pricing data gathering efforts, you will miss significant revenue and profit opportunities. Why leave money on the table unnecessarily?

With the incomplete picture that most pricers must work from, the primary power that influences a company's pricing is the customer. Consumers today are very well informed about the value of the goods and services they want to procure. Part of the procurement process is comparison of information about suppliers under consideration; the ready availability of this information puts a lot of bargaining power muscle on customer's side while weakening the supplier's side. Often, in order to capture the business, a company makes concessions that further weaken the pricing function and skew the advantage even more toward the customer.

It is important to add muscle to the pricing function by capturing data that customers are gathering as well as additional information about the market as a whole. Though much of this information can be capture through an ERP system, finding a way to gather current data (i.e., from today or this week) will tip the scale toward the pricer and result in stronger bargaining power, which in turn allows capture of more revenues and profits.

This paper discusses how to gain bargaining power muscle in your pricing function through the right intelligence capture and what actions to take to tip the pricing scale in your favor.

Perceived brand value is highly dependent on price. Setting a price in synergy with marketing strategies requires up-to-date external market data. Unfortunately, the data collection process is cumbersome, mostly manual and therefore expensive. This is why most companies have insufficient data at hand to support their decision making process. The result has a damaging effect on perceived brand value.



The Impact of External Data on Price

Here is a simple example that illustrates how external data can impact pricing strategy.

Triple-A Company sells a basic electrical tool. Price is currently set based on historical transaction information and revenue goals for this year. The average historical price of the tool is \$100, which breaks down like this:

- Variable cost - \$60
- Fixed cost - \$30
- Profit \$10

The company has realized \$100M in revenues on 1M units sold, which has delivered \$10M in profit.

Management decides to gather competitive pricing intelligence on a similar tool. Findings indicate that the average competitor price is \$110 (10% higher than Triple-A's price). This knowledge allows Triple-A pricers to propose a price increase that will not erode the company's customer base:

Average Price of Competitors	\$	110
New Price	\$	105
Variable Cost	\$	60
Fixed Cost	\$	30
Units Sold		1,000,000
Revenue	\$	105,000,000
Profit	\$	15,000,000
Profit Increase		50%

By increasing the price by \$5 per unit, Triple-A still remained lower cost to customers than competitors, so there would be no loss in business related to the price increase. And, this increase will generate an extra \$5M in profit, which is a 50% gain over the previous price.

Though greatly simplified, this example is an accurate representation of the impact that gathering external pricing data can have on revenues and profits by way of revamped pricing strategies.

How Customer-Based Data Can Tip the Scale

The internet is full of market data. Sophisticated e-procurement systems (B2B) and price comparison web-sites (B2C) provide the consumer with a level of intelligence that puts a lot of bargaining power in their hands. These systems and web sites operate so closely to real time, and keep the buyers so well informed, that the pricer is often put at a power disadvantage. Customers and procurement agents can react to changes in the market much more quickly than was once the case. Unless they are armed with the same near-real-time virtual information capabilities, pricers lose ground quickly either by eroding profits or by losing customers to more price-agile competitors.

Profit erosion and potential loss of customers due to price are serious risks in a B2B environment, where Pareto's principle (also known as the 80-20 Rule) applies to most companies; that is, 80 percent of revenue is generated by 20 percent of the customer base. These "key accounts" have no problem flexing their pricing muscles, and regularly "dictate" prices, squeeze margins, and leave pricers powerless to strike a better deal for the company.



One way to add muscle to pricing and gain ground from key customers is to proactively survey both the company's entire customer base and the prospect population. Data gained from customer and general consumer feedback can make a significant difference to pricing strategies and can also provide pricers with bargain power of their own.

External Data Gathering: The Value of a Third Party Partner

We talked to Christian Koestler, CEO of Lixto, about the significance of external pricing data and options for gathering, analyzing, and acting on it.

Wipro Pricing & Profitability Solutions: [WPPS](#), Christian Koestler: [CK](#)

WPPS: We are talking here about the role of external pricing data in increasing the bargaining power of the supplier. However, this kind of information has not been a key part of the pricing function in the retail operations of the oil and gas industry. Why hasn't the power of external pricing information been tapped into?

CK: There are two reasons why companies have not made use of external pricing data. First, pricing has traditionally had an internal focus, meaning that prices were set based on manufacturing costs, profit margins, and similar factors. Second, and this is true for oil and gas retail pricing, there has been more attention paid to the B2B side of pricing and not to the B2C side.

WPPS: What makes the B2C side so significant now?

CK: The internet. More and more retailers and e-tailers have recognized the need to have products on the web, not just for sale but as reputation builders because of the increasing strength of consumer opinion through online reviews. This has resulted in a very rich source of external pricing data. This data includes, for example, the price a competitor is charging for a comparable product as well as customer ratings.

WPPS: Why are the customer ratings significant? Isn't that more of a marketing and brand management concern?

CK: Online ratings and reviews are certainly of great interest to marketing and brand managers. Pricing managers are also recognizing their importance. For example, Company A may be charging \$1.50 for a product that has a 5-star rating while Company B offers a competing product for \$1.20 with a 2-star rating. Without the rating data, a Company A pricing manager is more likely to adjust the price downward in order to stay competitive; the difference in customer opinion, however, can actually result in more sales at the higher price.

WPPS: This sounds simple and straightforward so far, but if we multiply the number of products and the number of websites that pertain to a company, things get a lot more complex. How can a pricing department gather and analyze such a massive amount of information from the internet?

CK: Yes, the actual numbers are quite large. It is not unusual to capture thirty or forty thousand price points per day from websites. That information must then be analyzed and released in a form that is useful to stakeholders like pricing managers, sales managers, category managers and brand managers.

There are basically three choices to do this. All of them are based on technology, with each relying on automation to a greater or lesser degree. At the end with the least amount of automation, a company would need to use employees or contractors to pull the data from the web, "manually" analyze it, and compile reports. At best, this provides a static snap shot of pricing information at a given point in time—which can often be weeks or even months in the past.

The next option is to program an automated solution in house. IT staff could create a system that captures and analyzes the information automatically. There are several drawbacks to this approach: First, the capital investment in this kind of effort would be significant; second, maintenance of such a system would demand ongoing resource allocations; third, great care would need to be taken to ensure that system operation does not negatively impact the web sites from which information is captured.

The third and most automated option is to use a fit-for-purpose third party application such as Lixto. This allows a company to obtain a daily update on prices in its market and also provides role-specific analyses that are accessible via a dashboard-style interface. Management can get nearly real-time views of market activity related to price: How competitor prices have moved up or down, for example, or how prices have changed in a specific geographical region or product category. Pricing managers can get very specific pricing information while category or sales managers can get a broader view of trends and competitor strategies. In addition, the system itself is managed and maintained by a third party provider who makes sure that data capture adheres to regulatory requirements and does not disrupt source websites.

WPPs: Should a system like this provide the ability to test pricing strategies?

CK: Absolutely. This is a very important part of the power of external pricing data. For example, a robust system will allow management to gauge the company's price leadership position by product or product category. A pricing manager could run simulations on the system to see how different prices changes would affect the price leadership position. They would know beforehand how a one percent change would impact their leadership position which in turn would impact sales. Think about the additional margin potential if you are able to find out that a 2% price increase will not affect your price leadership position at all.

WPPs: As you've mentioned, Lixto offers the highly automated option that you outlined. What benefits have your clients reported as a result of implementing Lixto?

CK: At first I need to mention Lixto's key differentiators. We are the only company in this field that handles the data capture and analysis process entirely with technology. In fact, our data gathering technology was granted a U.S. patent in 2009. Lixto handles the entire process from start to finish; that is, from web data extraction on large scale, match own products with competitive products and finally provide analysis through role-specific reporting and simulation capabilities. If needed, the Lixto Price Intelligence Suite can also integrate with enterprise back end solutions which, for example, are managing product cost and historical deal structures. This adds an additional level of flexibility and value to the pricing function.

Now to benefits that our clients have reported. The primary benefit is the ability to respond to price changes very quickly, on a daily basis if they choose to do so. This translates into a much improved strategic position in terms of pricing; clients can better understand their competitive position and influence their markets with consistent pricing strategies. Another great advantage is the ability to have full visibility about the effectiveness of the set minimum advertised price (MAP) across all retailers; this allows the company to identify MAP-Violations and to reach out timely to the relevant retailers to ensure MAP-parity and help them to increase sales. Finally, we have clients who use Lixto to effectively enter into new geographic regions; they can quickly and comprehensively survey the pricing trends in the new area and align their own prices to compete successfully.

WPPs: Christian, thank you for sharing your insights with us. How can more information about Lixto be obtained?

CK: It has been my pleasure. If you are interested in further details please visit our website (<http://www.lixt.com>).

Pricing Muscle and Porter's Five Forces

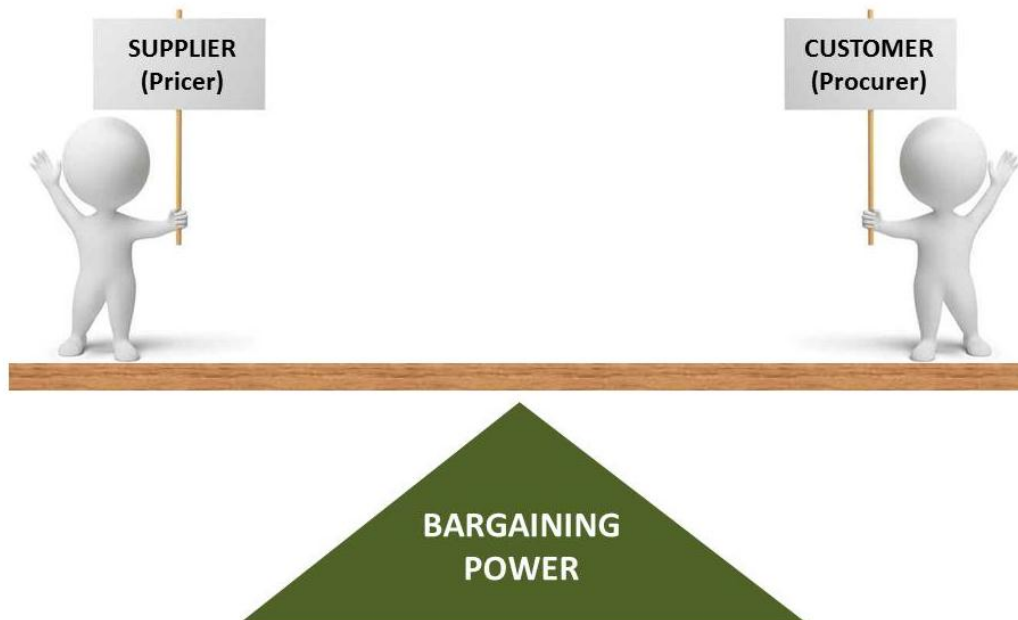
The significance of external data in building supplier side pricing power is best illustrated in the context of Porter's Five Forces. This model for industry analysis and business strategy development is named for its creator, Michael E. Porter (Harvard Business School). In the context of pricing muscle, the bargaining power of the consumer and of the supplier are two of the forces. The other three forces, threat of new entrants, threat of substitutes, and competitive rivalry, operate in favor of the customer and increase the pricing muscle on their side of the transaction.

In order to increase its pricing muscle, a company must find ways to offset or override the forces favoring the customer.

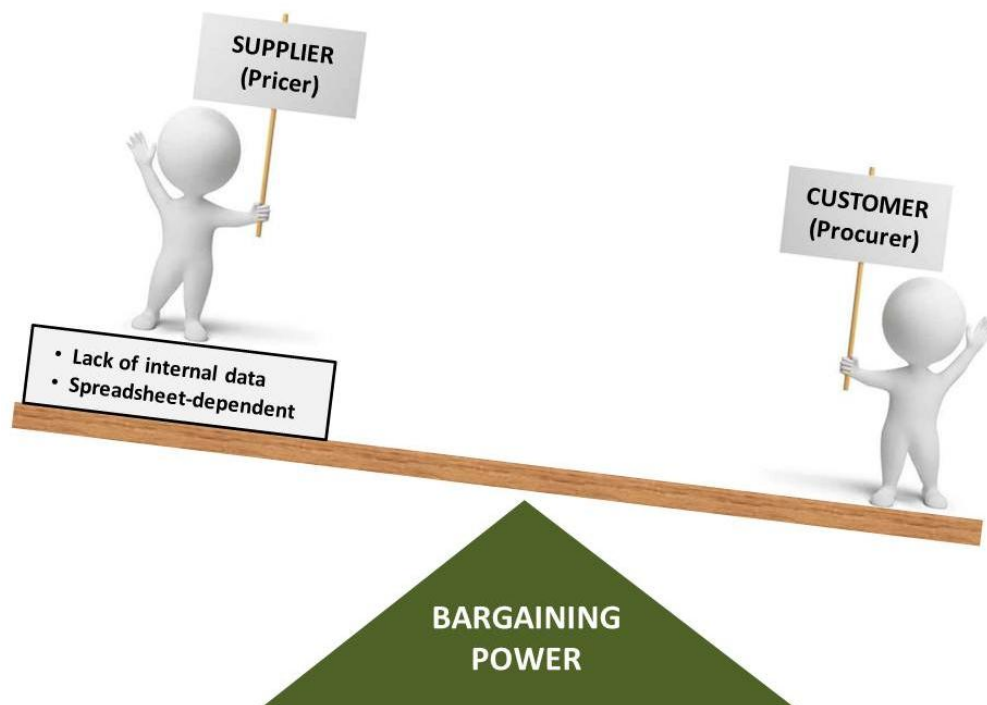


Pricing Muscle Scenarios

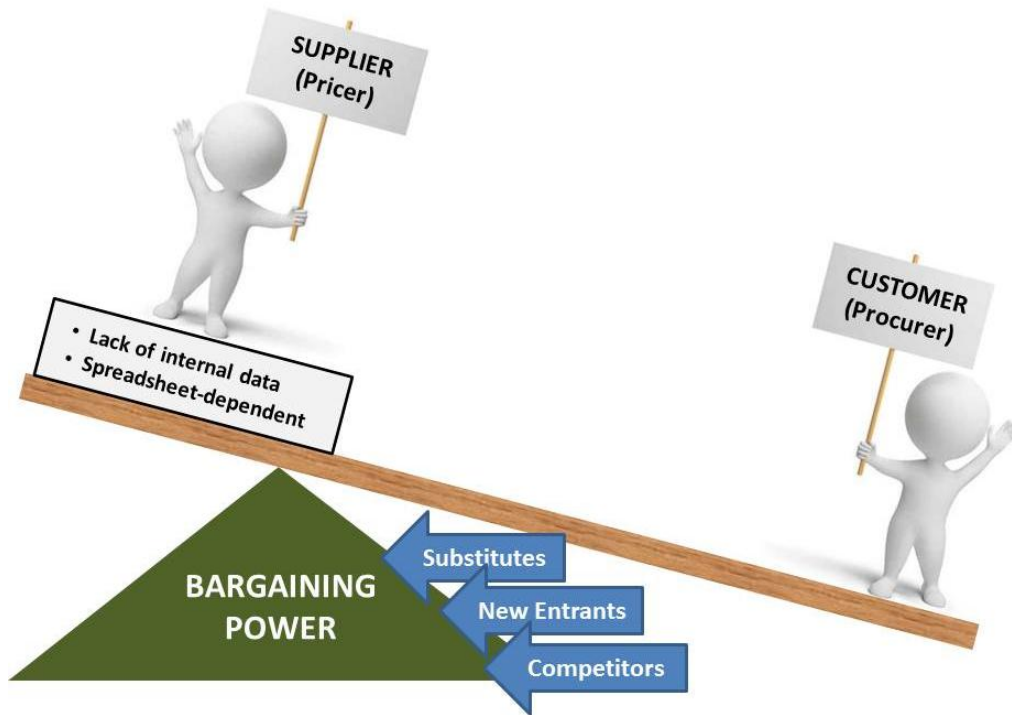
Picture a seesaw, with the supplier on one side and the customer on the other. The position of the fulcrum (i.e., bargaining power) determines which party has the most impact on price. When certain forces favor the customer, bargaining power shifts to add muscle to their side of the transaction. A company must find ways to move bargaining power into a position that puts muscle onto their side.



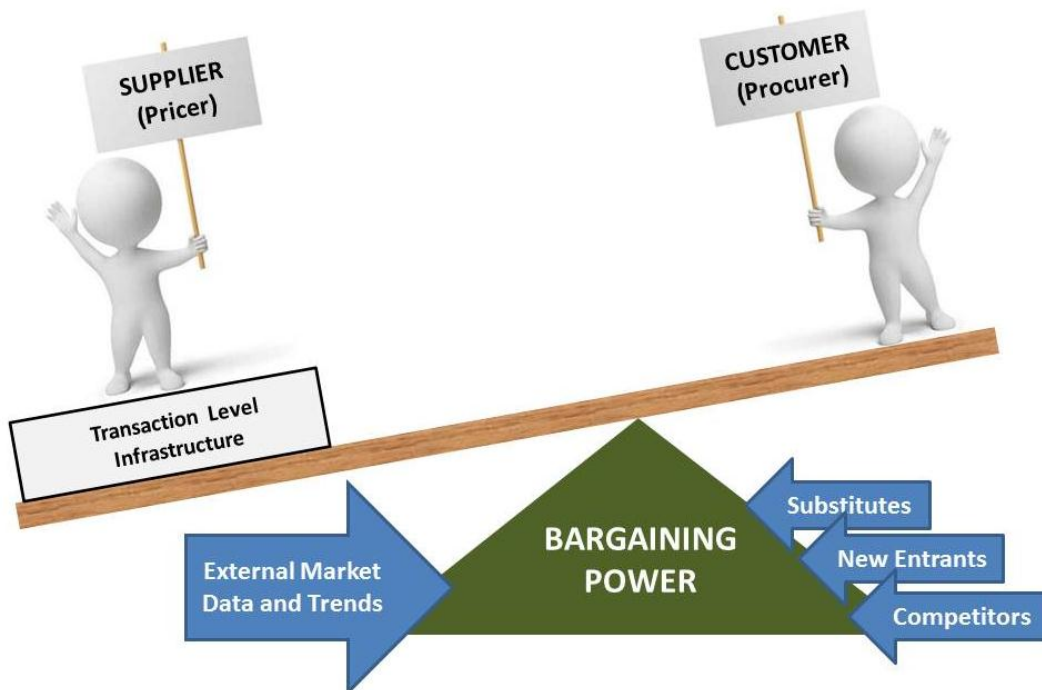
Scenario 1 is the initial and worst pricing situation for the supplier. The pricer lacks a transactional pricing infrastructure, so does not have access to reliable internal data. The pricer relies on spreadsheets and "seat of the pants" calculations. The procurer solution clearly has the muscle advantage, that is, customer bargaining power outweighs supplier bargaining power.



The second scenario shows how current competitors, threats of new entrants, and substitutes work in favor of that procurer by moving the fulcrum towards the pricer. This means that procurement has even stronger bargaining power.



Scenario 3 represents the effect of implementation of a transaction level infrastructure and capture of external market data. The transactional infrastructure adds muscle to the pricing power side (increases bargaining power of suppliers). External market data offsets the push of the market forces and brings the pricer back to center or, possibly, to the other side of the seesaw, which adds more leverage to pricing power. In this instance, the supplier's bargaining power is higher than that of the customer.



External Data in the Context of Porter's Five Forces

To maximize the impact of external data on pricing power, the right data must be gathered. The best way to identify the right data is to return to Porter's Five Forces. Table 2 offers examples of internal and external data that correspond to the model.

	Internal Data	External Data
Power of Customers	<ul style="list-style-type: none"> • Customer discounts • Customer margin • Customer revenue • Customer price sensitivity • Customer costs to serve 	
Power of Suppliers	<ul style="list-style-type: none"> • Supplier costs 	<ul style="list-style-type: none"> • Raw material indices • Supplier competition
Threat of Substitutes	<ul style="list-style-type: none"> • Value differentiation 	<ul style="list-style-type: none"> • Number of substitutes
Threat of New Entrants		<ul style="list-style-type: none"> • Customer research • Customer brand loyalty • Domestic trends • Events/holidays • Industry profitability
Competitive Rivalry		<ul style="list-style-type: none"> • Number of competitors • Competitor prices

In addition to those listed, there are other types of external data that can be collected and analysed to drive pricing strategy. Selection of data types should be made following criteria that align with the organization's market and objectives. Criteria may include:

- Sales channel (e.g., B2B, B2C)
- Perceived value comparison to competitor products (e.g. online product rating trends captured on a daily basis). Positive trends should result in immediate price improvement (i.e., price increases); the faster the decision, the more profit gets captured.
- B2B to B2C profit checks. Collect information about prices distributors are charging consumers for company products. Estimate their margins based on the prices charged to distributors, then look for B2C price movement. If consumer prices increase, should distributor prices increase as well?

Crafting Strategy from External Data

Pricing muscle comes from the strategies that get implemented as a result of external data collection and analysis. If a company is gathering the right information, the resulting strategies will have clear and positive impact on the bottom line. Table 3 offers examples of pricing strategies that may be implemented based on external data results.

External Data Group	Channel	Description	Pricing Strategy
Competitive Pricing	B2B	Competitor prices of same or similar market offering	Price = 95% of average price of top 5 competitors Apply Value Based Pricing
Consumer Research	B2B,B2C	Consumer surveys, product reviews/ratings of products online	Survey consumers on market offering features and prices. Run a Conjoint Analysis on results to determine price levels.
Market Indices	B2B	Cost of raw materials and supplies, commodities, etc.	Update price to incorporate dynamic changes to cost of raw materials and supplies. For every X% increase in costs, increase price by Y%.
Economic Indicators	B2B, B2C	Micro-economic and macro-economic indicators that measure price behaviour across different segments (geography, category, etc.). Examples: CPI, PPI	Monitor Consumer Price Index (CPI) and Producer Price Index (PPI) changes. For every X% increase in CPI, increase your price by Y%.
Weather/Temperature	B2B, B2C	Hot, raining	
Events	B2B, B2C	Holidays, Seasons	B2B: As a supplier, monitor sales orders during specific seasons, and just supplier costs. B2C: Bundle products and create promotions to sell high velocity products during high traffic seasons or events.
Google Domestic Trends			

Putting Pricing Muscle into Lubricants

Wipro surveyed the oil and gas lubricant sector to identify pricing leverage points and the extent to which external pricing data is being captured and used.

Highlights of responses include:

- Price review and adjustments generally occur on a quarterly basis.
- Pricing strategies are predominantly competition-based and target-based for existing products and value-based for new products.
- External market data most frequently used for pricing are competitive price information, consumer research results, and economic indicators. These are usually applied to existing products rather than new products.
- Brand loyalty and value were identified as the most important value drivers.
- Power of Customers and Competitive Rivalry were most often cited as the Porter Forces with most impact on pricing strategies.

Companies operating in this sector could gain significant competitive advantage in a highly competitive market through more extensive use of external data. For example, brand value trends should be gathered and compared to competitors on a daily basis. An upward brand value trend should support a price improvement to reinforce a product leadership position.

Conclusion

Building pricing muscle must include capture and analysis of external data to drive pricing strategy. Porter's Five Forces offers an effective structure to determine which type of external data to capture and to increase the bargaining power of the pricer. The right data will facilitate creation and implementation of strategies that effectively counter the threats of new entrants, competitive rivalry, and substitutes.

Pricing organizations can benefit greatly from partnership with third party providers (e.g., Lixto) to capture and analyze external data. The internet is a rich source of information and also requires a highly complex system to handle capture and analysis effectively. Taking advantage of third party expertise in this area will deliver data upon which immediate action can be taken.

In the lubricants sector, pricing organizations can help products improve market position in a highly competitive market by expanding the range and frequency of external data capture and using that data in strategic ways. A third party partnership to facilitate external data capture and analysis will help increase pricing muscle and lead to new strategies that increase profits and revenues through price improvements and better market position.

About the Authors

Mirko Brinker is a consultant with the Wipro Pricing and Profitability Practice. He graduated from Imperial College Business School with an MSc in Management and from Copenhagen University College of Engineering with a BEng in Electronics and Computing. Mirko is a Prince2 certified project manager and has several years of experience as a consultant. Prior to joining Wipro, he founded and managed his own consultancy with two employees and worked as a consultant / project manager for two leading ICT providers in Europe, the US, and Brazil.

Ahmed Megahed is a Manager of Pricing & Profitability Solutions at Wipro Technologies. He has a distinctive skill set revolving around Business/Marketing Strategy and Information Technology, including: innovative problem solving, best practices, proven leadership, account management, solid negotiation tactics, and exceptional communication with C-level executives.

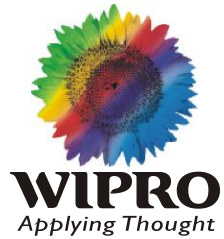
Ahmed's depth of experience includes developing and documenting pricing and marketing strategies as well as business process improvements for major companies. Most recently, Ahmed is helping develop the Wipro's Pricing & Profitability Solutions practice for the Energy, Natural Resources, and Utilities sectors, managing the relationship with vendors and showing clients how to leverage pricing to increase profitability. Ahmed earned a B.Sc in Computer Engineering and an M.B.A from the University of Houston, achieving Magna Cum Laude Honors. He is a member of the Professional Pricing Society, a Texas Business Hall of Fame Scholar, and is fluent in the Arabic language.

Mark Allen is a Partner in Wipro's Global Energy Consulting Practice. He has over 20 years of experience in the oil and gas industry, first as part of a super major and then with two global management consulting firms. Mark has a proven track record helping clients with process improvements, cost management, system implementations and strategy execution. Prior to joining Wipro, Mark was the upstream industry lead for SAIC's oil and gas practice, with a focus on upstream oil and gas, and midstream natural gas and liquids energy segments.

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