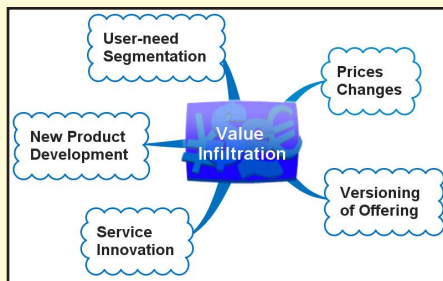


Infiltrating Value-Based Pricing in an Organization



The journey towards value-based pricing is long and can be tenuous, and there are many potential roadblocks along the way. In this paper, the author briefly presents these roadblocks and analyzes why organizations are reluctant to implement value-based pricing in their core business. The author also presents another approach to integrating value-based pricing slowly and progressively through various entry points in the cost-based or competition-based fortress. Stephan Liozu, CPP (www.stephan-liozu.com) is a member of the PPS Board of Advisors, the Founder of Value Innorup-tion Advisors and specializes in disruptive approaches in innovation, pricing and value management. He earned his PhD in Management from Case Western Reserve University and can be reached at sliozu@case.edu.

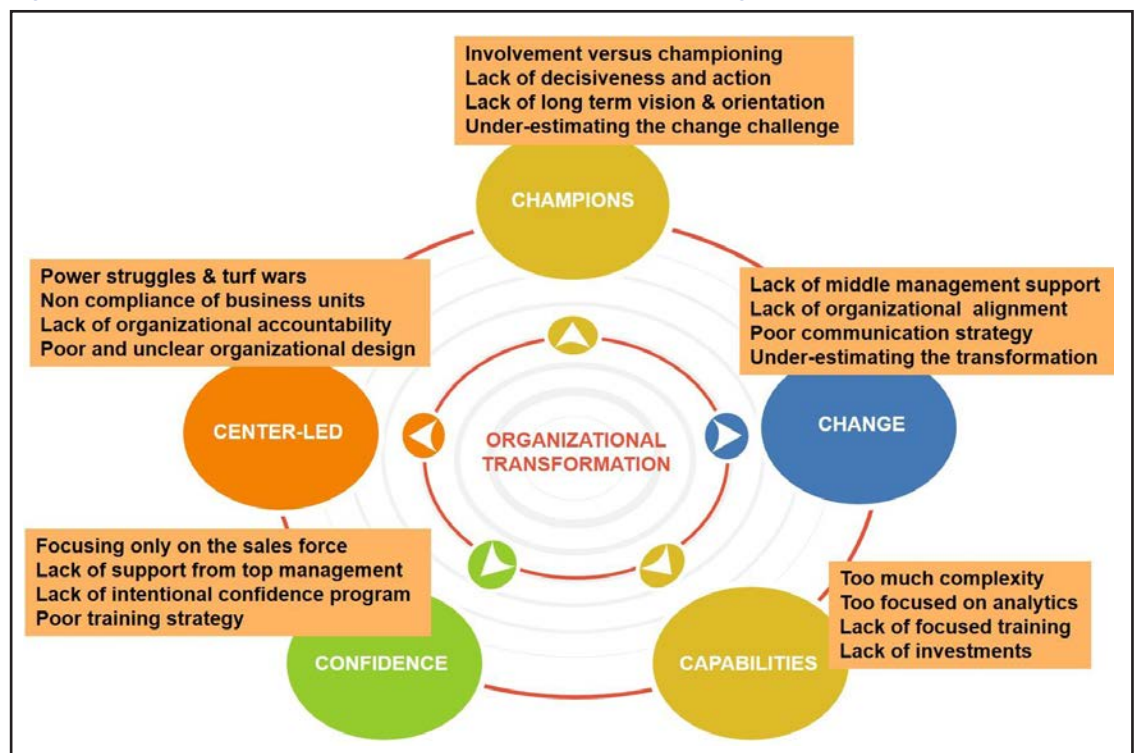
Over the past four years, I have researched value-based pricing through the marketing and management lenses. As a practitioner-scholar, I have been able to understand this modern pricing orientation and what it takes to deploy and internalize it in organizations (Liozu, Hinterhuber et al. 2012). The outcome of my research journey is the development of the 5C model of pricing transformation which includes a roadmap to move from formula-based pricing to customer value-based pricing. The journey towards value-based pricing is long and can be tenuous. As a matter, there are many potential roadblocks along the way. In this paper, I briefly present these roadblocks but I also focus on why organizations are reluctant to implement value-based pricing in their core business. Finally I present another approach to integrate value-based pricing slowly and progressively through various entry points in the cost-based or competition-based fortress. I call this the infiltration approach of value-based pricing.

Traditional Barriers to the Implementation of Value-based Pricing

Academic attention to the pricing and economic value assessment in business markets has generally intensified. The publications on value-based pricing adoption point to difficulties in making value assessments (Hinterhuber 2008), complexity of value assessment tools (Anderson, Jain et al. 1993), interdepartmental firm conflicts (Lancioni, Schau et al. 2005), reluctance from purchasing managers to accept higher priced offerings, increased

competitive intensity of markets (Ingenbleek, Debruyne et al. 2001) and lack of top leadership support (Hinterhuber and Liozu 2012) as impediments. Other barriers relate to value communication, incentive alignment, lack of strategic pricing capabilities and market segmentation. Figure 1 below shows the 5C model of pricing transformation and the most common barriers to the implementation of value-based pricing. So as you can see, there are a lot of things that could go wrong during the transformational process. It is not an easy deployment and internalization. While capabilities, center-led management and championing are more intuitive and more common sense, the dimensions of change and confidence are the ones that are the most neglected during the design and implementation of value-based pricing.

Figure 1: 5C Model and Most Common Barriers to Value-based Pricing Implementation



Change management activities must focus on getting everyone on board the “change train” by conducting a thorough stakeholder analysis and developing “what’s in it for me” messages for each stakeholder. Many times, change stalls because people are not shown a clear vision of the value-based pricing outcome or are not clearly aligned. The second neglected dimension is the organizational confidence factor which is closely related to the concept of change. Developing confidence at the organizational level requires the development of a strong belief system for every function involved in the value-based pricing initiatives. That includes much more than sales. Innovation, marketing, finance, and supply chain teams also need to be trained. It requires the designing and execution of dedicated training programs using concepts and methods from experiential and transformation learning theories (Liozu, Hinterhuber et al. 2012). The end goal is to develop organizational self esteem so that teams can take on the challenge of value-based pricing transformation. Conducting traditional lecture-based pricing training is not adequate to transform people’s mindset.

The Untouchable Core Business

More recently, and in the context of the on-going economic crisis, I have come to realize that deploying value-based pricing in the core business of an organization is a very challenging proposition. During times of uncertainty, business leaders are very sensitive to making changes and to taking on difficult transformations. The core business becomes a fortress to protect even if leaders realize that their pricing orientation is not the most progressive in the world. In my discussions with numerous pricing practitioners, whose transformational projects were derailed or stalled, I was able to identify some of the factors behind these types of behaviors:

1. **Priorities are set:** In times of crisis, business leaders might put more emphasis on cost management and operational excellence in the core business. Because budgets are tight and resources are constrained, it might not be the right time to launch a value-based pricing project.
2. **Reluctance to take business risks:** Taking business risks during a crisis is not something that most business leaders are comfortable with. Deploying value-based pricing might require introducing products at a higher price with the potential implications that might have on volume and market share.
3. **Reluctance to change:** Changing during times of uncertainty reinforces the potential “trauma” associated with the changes in roles and responsibilities. It is undeniable that deploying value-based pricing in an entire core business requires a lot of changes in the selling process. Resistance

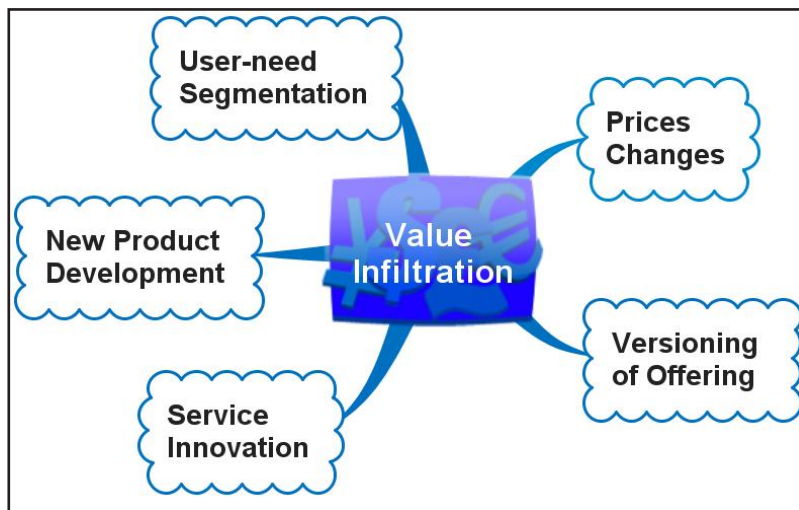
to change might increase strongly in that context.

4. **Level of commoditization of the core business:** Right now, many firms have lost differentiation in their core business and are struggling to justify price premiums. This long crisis has eroded business models and the levels of customers’ willingness to pay. Competitive pressure reinforce the use of formula-based pricing approaches (Ingenbleek 2007).
5. **Focus on market share:** I have spoken with many firms who have taken a defensive position for market share protection hoping for a return of higher demand level in the near future. That makes the discussion for the need of value-based pricing difficult. The attention is somewhere else and all processes are focused on volume and market share optimization. In such a context, leaders are not willing to walk away from deals and from volume opportunities.

These are temporary behaviors in organizations. But the crisis has gone on for over 5 years now and behavior changes have become ingrained in the organizational culture. Pricing professionals have to recognize the difficulty of this long crisis on management and on teams. They have to take a different approach to bring progressive and modern pricing to the core business. Making the case for an organizational transformation towards

value-based pricing in the core business might not be the most realistic approach. A better approach might be to start with adjacent businesses and those that are not the “bread and butter” of the organization. Pricing professionals might also consider starting with small and differentiated businesses in and out of the core business. I propose a disruptive approach to getting started with the journey. It involves identifying the potential “cracks” in the core business fortress and infiltrating value through these cracks. This

Figure 2: Slow Infiltration of Value-based Pricing



is what I call the value-based pricing progressive infiltration in the core business.

The Infiltration of Value in the Core Business

The overall objective of the infiltration process is to inject small doses of value-based pricing through various innovation, marketing and sales processes. So it is all about staying away from big-bang deployments but rather focusing on smaller programs where the chances of acceptance and success might be greater. Pricing professionals can then leverage these “cracks” or opportunities to inject the value story in the core business while being sensitive to the organizational behaviors I highlighted in the previous section.

I propose five areas of potential infiltration of value in the core business as shown in figure 2. There might be more but I will

briefly describe these five to generate some thinking and dialog within the pricing community.

1. **User-need segmentation:** Most companies regularly revisit their segmentation strategies and validate the robustness of their customer segments. In doing so, they also open the door to a potential modification of the marketing strategy for each segment including pricing strategy. Pricing professionals should be aware of these exercises and make sure they participate in the overall process. This is a unique opportunity to revisit pricing strategy and segments' willingness-to-pay. This opens the door for price level discussions for targeted offerings in each segment.
2. **Price changes:** Another opportunity to inject value-based pricing knowledge in the core business is during the preparation and execution of price changes. When price increases are prepared, products with greater pricing power are typically considered for higher price increase levels. During these discussions, pricing professionals can introduce the concepts of value maps and value models. Generally speaking, it is better to base pricing increases on the value differential versus competitors. In reality, most firms base their price increases on what cost increases they received from suppliers. In the price change process, the EVE® method can be a good one to show differentiation value as competitors also make price changes. This is an excellent opportunity to plug value-based pricing tools as part of the price change management process.
3. **New product development:** This is probably the most powerful point of entry or "infiltration" avenue for value-based pricing. Innovation and pricing teams should work closely at extracting the value from innovative products and performing the EVE® process. Each new product opportunity would be evaluated based on net differentiation value and assigned a price based on customer value. The customer research necessary to support this exercise can be done in conjunction with the innovation team. The end goal is to make sure that each new product entering the core business does so with the right price based on customer perceived value and estimated willingness-to-pay. Slowly and over years, the core business integrates right-priced products and my experience shows that the product mix improves especially if your organization has a high innovate rate. Deploying value-based pricing in the innovation process requires a robust training program for the innovation team, the integration of value and pricing methods as part of the NPD or Stage-Gate® process, and the evaluation of the new product portfolio based on margins and estimated differential value.
4. **Service innovation:** The same goes with service innovation whether a firm is in the service industry or in manufacturing. There are new services in the core but also services around the core, and corporate services. Value-based pricing can help assess the value of these services and create

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price menus with various levels of service performance. The critical step is to monetize the value of services and to use them to justify price premiums. If your product offerings are somewhat commoditized, offering valuable services might be the answer. Pricing professionals need to make sure these services are not given away for free.

5. **Versioning of offerings:** One size does not fit all. As part of category management, various performance/price profiles might be introduced to the market in response to specific customer needs. When product management is considering a new version in a specific product or service line, it is an opportunity to set the price based on customer perceived value and not based on cost. In that case, pricing professionals can support pricing strategies with the analysis of trade-off between performance and price by running a conjoint analysis for example. They can support product management with the pricing strategy for the whole category by injecting more voice-of-customer research.

Conclusions

If your company is going through a rough time, stay away from proposing a big-bang deployment of value-based pricing. This is going to scare everyone off. You might not be successful at making the case. If you are successful, the level of resistance you might encounter might also be very high. A better approach is to inject the value story at multiple entry points and to slowly infiltrate the core business. This is a better approach than to throw in the towel and not try anything.

The best approach is to work closely with your marketing and product management group and to leverage any opportunity you may have to apply value-based pricing tools and methods. The best bet is to start with the innovation process. Working directly in the core business is not an easy proposition when prices are set, customers are educated and the sales force is comfortable with price levels. Introducing new products that are priced based on customer value allows you to make the changes required slowly and progressively. To get started, invite your innovation colleagues to attend a basic training session on value and pricing. Get them familiar with how best-in-class innovation companies use advanced value and pricing concepts in their innovation process. That might resonate well with them.

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