



Precision Pricing:

**How to Improve Profitability
Through a Disciplined Value Approach to Pricing**

**A Case Study
of a U.S. Manufacturer of Sensor Controls**

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CASE STUDY: Manufacturer of Sensor Controls

50% Increase in Profits: U.S. manufacturer, with annual turnover of \$70 million, increased profit before interest and taxes from \$4 million to \$6 million.

Executive Summary

Client Profile: U.S. Manufacturer of Sensor Controls—part of a \$500 million Product Group owned by a U.K. based publicly traded worldwide OEM Manufacturer

- Plant General Manager had full P&L responsibility.
- Plant Manufactured: Five major Product Lines.
- Revenues totaled \$70 million, Profit before Interest and Tax was \$4.0 million.
- Factory: 150,000 sq ft., One Shift, 150 Employees.
- Founded mid 1950s.

Pricing Team: Five individuals, plus an External Team Leader.

Period of Study: 15 weeks (mid October to end of January)

Background: The U.K. Group Chief Executive was looking for ways to increase overall profitability. A U.S. based Divisional Director agreed to sponsor a pricing study in one of his smaller Product Groups, and the Sensor business was chosen as a good launch pad as it was struggling to increase profitability.

There were three major obstacles to overcome.

1. **The local Sensors Management was initially skeptical** that an outside body could uncover opportunities that would lead to a “minimum” 1% increase in price. In particular, the experienced Sales and Marketing Director realized his departments would come under strong scrutiny, and he was initially hesitant to allow an in-depth study of his internal affairs.
2. Finding the **internal staff resources** to support the program proved to be a major challenge.
3. The pricing program required **high levels of detail**. There was a need to accurately populate an Excel spreadsheet with details of every line item sold over the most recent twelve month period. Each entry had to start with its list price and end with its final contribution to Selling and Administration overheads with all “profit leakage points” being clearly allocated to specific products and customers.

Senior Management commitment was pivotal in overcoming these obstacles, and, by their ongoing support for the program, they had a significant impact on the team’s effectiveness.

The Results: The outcome of the pricing program was significant.

- **50% increase in profits:** A total of \$2.1 million of additional profit opportunities was identified (equivalent to 3% of sales and a 50% profit before tax improvement).
- **Ongoing organizational discipline:** To successfully capture these pricing opportunities and to ensure the improvements were maintained, the plant required a new pricing organization, new reporting mechanisms and clear pricing accountability with authority over all product lines.
- **More effective commission structure:** External sales were given product profitability information and commissions were based on achieved margins rather than sales volumes.

Program Overview:

The Team: Members came from both within the plant and from the external consultants and were chosen for:

- Their knowledge of the company's product lines,
- Their personality and ability to go out and interview customers,
- Their "inquiring minds" and good data manipulation abilities - comfortable using Excel spreadsheets and pivot tables.

It was important to create a representative multi-disciplined team. The combined skill and knowledge set was invaluable, and it ensured all key departments were involved in the process.

Team members had to commit to providing at least 60% of their time to the project. This required Senior Management to provide additional resources so their day-to-day responsibilities were adequately covered.

The in-house team was a combination of Internal and External Sales, the Controller, the Manufacturing Plant Supervisor and a representative from a sister company (so the experience gained could be transferred and leveraged throughout the Division).

Other in-house resources were allocated to the team as necessary. In particular, in the early stages a senior IT person was instrumental in helping create the database, as it required pulling data from the costing system and the overhead sections of the ERP system, and populating an Excel spreadsheet. The Controller then scrubbed the data clean to ensure the integrity of the custom database was unquestionable.

The Plant Manager had to resource the program with individuals who had the appropriate skill set. The external consultants were able to provide additional customer interviewers and data analysts, and eventually the team make-up became a combination of both internal and external individuals. Some of the deciding influences were:

1. Company employees already had a good understanding of their products, their customers and to some extent the competitive environment.
2. After the completion of the study there would be the need to form a small pricing team to "institutionalize" the program, and certain skills had to be retained within the plant; they could not be allowed to walk out of the door.
3. If the consultancy provided more external resources, they would need to be educated in the base business, but they could easily be used for data analysis, report presentations and database "cleaning." This also allowed in-house individuals more time to ensure their ongoing daily responsibilities were not seriously jeopardized.
4. Customer feedback would probably result in more meaningful and honest insights if outsiders were used to conduct the external interviews, especially in the key area of competitor price discussions.

The Team Leader was an external Pricing Management specialist who provided the pricing expertise and overall project management. He also assumed overall responsibility for the final accuracy and timing of the transactional database – a critical element of the program.

Timelines and Deployment:

Part 1 - The First 6 weeks

Each team member chose one of the five major product lines to investigate. They were each made responsible for collecting and assessing base business and market data to determine the overall position of their particular product line.

The prime objectives were to:

- a) Determine which products, if any, were “value advantaged” in the marketplace, and
- b) To uncover areas of price and/or profit leakage which could be plugged, with no significant loss of volume.

The assessment took two forms:

- a) **Value Maps** were developed internally which compared key product benefits and relative price levels with those of major competitors’. These were refined by conducting external face-to-face customer interviews to ensure market intelligence was accurate.
- b) **Pricing inefficiencies and compliance issues were investigated** by completing a “Deep Dive” into a year’s transactional data. Excel spreadsheets and pivot tables sliced and diced the data. Detailed margin analyses: by customer, product, salesman, import and export were produced and examined for pricing opportunities.

The current pricing methods of each product line were documented and potential improvements were noted. These were later used as the basis for restructuring the company’s pricing organization.

Part 2 - The Next 4 weeks

The team identified immediate price/margin improvement opportunities or “Quick Hits” from initial examination of the product Value Maps and the transactional database. The overall economic impact of all the initiatives was estimated, and a top-level implementation plan was set out.

Part 3 - The Final 5 weeks

The immediate **Quick Hits were implemented**, and the longer-term program to achieve the remaining pricing opportunities was initiated. A **new approach to pricing management was laid out** and the necessary training, communication documents and programs were developed. This ensured the new discipline was institutionalized, so the benefits of the program could be captured year after year.

Seven specific pricing recommendations came from two distinct areas.

**Full Year
Impact**

Competitive Market Position Analysis:

1) *Two Value Advantaged product lines - selectively increase list prices by between 5% and 20%* \$ 565K

In-depth analysis of a years sales and accounting data:

2) *Tighten compliance to quantity price list. Reduce quarter-end revenue chasing discounting* 340K

3) *Adopt more aggressive approach with low and negative margin customers* 413K*

4) *Initiate program to re-price samples and customer led engineering projects* 180K

5) *Invoice full freight charges – no longer pass on UPS group negotiated discounts* 125K*

6) *Improve Accounts Receivable collections by 10 days* 55K

7) *Introduce new Price List for Product Line Z, specifically to improve low margin accounts* 380K

Total Profit Improvement **\$2,058K**

* These Quick Hits were implemented during the 15-week investigation.

Numbers one through three are explained in more detail on the following pages.

Details of Pricing Opportunities 1 thru 3

Full Year Impact
\$565K

1) *Two Value Advantaged product lines - selectively increase list prices:*

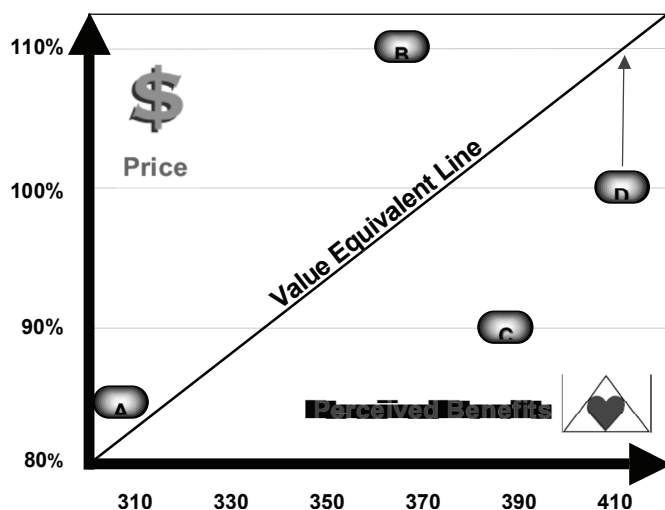
The Value Map of one of these product lines is below, and it shows the price versus benefit trade-off in the U.S. Silicone marketplace. There were four major players. The company's product line was "D," and it appeared to offer superior benefits compared to its competitors.

After exhaustive interviews (both in-house and with customers) it was determined that the broad Silicone product line had a remarkable technological benefit in the 9000 product family. On the basis of this Value Mapping, management increased prices by 20%.

The rest of the range could support increases between 5% and 10%, and the total annual benefit on this one product line alone was estimated to be between \$300K and \$400K.

During the investigative period it was found that the pricing supervisor in the plant had a tried and true formula for pricing these custom products, but the factory overhead fixed cost element had not been changed for over 20 years. He was particularly proud of his 90% successful conversion rate as it "kept the lines running." This discovery further supported the recommendation to raise prices.

Value Map of Silicone Market



Price Increase Details for "D"

Product Family	Revenues	High Volume	Low Volume
9000	\$ 543	20%	20%
9001	595	-	5-8%
9004	530	-	5-8%
9100	4,203	5%	5-8%
9106	882	-	5-8%
9150	801	-	5-8%
9156	206	-	5-8%
9200	807	-	-
9500	337	-	-
9600	333	-	10%

EXPECTED IMPACT OF \$300K to \$400K

Full Year Impact
\$340K

2) *Tighten Compliance to quantity price list:*

During the investigation into current pricing methods in the plant, it became clear that the internal sales department had not kept to the quantity break points in the published price book.

Over the years, the five individuals had authorized additional price discounts, especially at quarter-ends to meet their short-term targets. Crucially, there was no formal mechanism in place to monitor these exception “deals” as they were entered into the system.

It was recommended that as new orders were placed, prices had to fall into the correct pricing column. This would require a personal explanation to affected customers by the Sales Director. The annualized benefit was estimated at \$340K - after a 25% allowance for lost business.

Product Line	Book Price Revenues	Discounts Given	Effective Discount	Target Discount	Expected Impact
Group A	2,853	1,055	37.0%	27.1%	281
Group B	2,736	1,749	63.9%	62.1%	50
Group C	2,716	392	14.4%	9.9%	122
				Impact - no volume loss	453
				Less 25% expected volume loss	(113)
				Total Annual Benefit	\$340K

Full Year Impact
\$413K

3) *Adopt more aggressive approach with low and negative margin customers:*

This required a more aggressive approach to managing relationships with very low margin customers. During the Deep Dive analysis of the margins achieved by specific customers it became clear that many customers over the years had gradually moved the goalposts in their direction. This was considered so important that it became a Quick Hit, and it was implemented during the final stage of the 15 week pricing study period.

After clear and concise discussions with every customer, the following remarkable results were achieved:

Product line “H”

13 identified customers representing \$2.5 million of sales
 Average **21%** price increases were implemented, with a **60%** acceptance rate \$315K

Product line “P”

53 identified customers representing \$1.3 million of sales
 Average of **6.4%** price increases were implemented with an **80%** acceptance rate \$ 67K

Product line “T”

19 identified customers representing \$0.35 million of sales
 Average of **10.0%** price increases were implemented with a **90%** acceptance rate \$31K
Total Annual Benefit \$413K

The Composition of the New Permanent Pricing Team:

Four individuals were appointed; the first three had been part of the initial pricing team. Each had clear responsibilities, and their expected time commitments calculated.

<u>Position</u>	<u>Responsibility</u>	<u>Estimated Hours/Year</u>
Pricing Manager	Lead Monthly Meeting, final arbiter of pricing recommendations	400
Competitive Information Gatherer	Update Value Maps, customer interviews, new product pricing	160
Data modeling Expert	Track performance improvements, run pricing waterfalls and margin analysis	450
Process Fix and Implementer	Develop & implement new procedures, accountability, targets	400

With hindsight the Critical Factors for Success were:

Soft Factors:

- a) Senior Management enthusiasm was critical
- b) Clear Allocation of Responsibilities & Timelines by the Project Leader
- c) Team Members should be well balanced and have good skill sets for data manipulation and interview techniques
- d) Adequate back-up provisions made to cover Team Members' day-to-day responsibilities

Hard Factors:

- a) Database integrity with accurate standard price lists and product costing
- b) Value Maps - ensure true competitors for the specific buying segment had been chosen, and the data was verified by external customer interviews
- c) Accuracy of perceived benefits and competitive prices were critical in the creation of the Value Maps

Conclusion:

The realization of a 50% increase (\$2 million) in pre-tax profits require a serious and ongoing commitment by Senior Management. The project leader needed to engender a sense of purpose, and the team members all needed inquiring minds.

In this case, the study paid for itself with the implementation of the three Quick Hits, a fairly common occurrence in these programs.

The benefits derived from accurate Value Mapping, the implementation of the new pricing procedures and salesmen incentive programs were all achieved within a year. It required an ongoing investment in a permanent Pricing Team to ensure the discipline “stuck” so the results could be maintained year after year.

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