Five Areas to Explore Before Embarking on Value-Based Pricing Programs

by: Stephan Liozu, Ph.D., CPP

In this article, the author presents best practices for initiating an organizational transition towards value-based pricing. Stephan M. Liozu, Ph.D. (sliozu@gmail.com), is the Founder of Value Innoruption Advisors, a consulting boutique specialized in value-based pricing, industrial pricing, digital and subscription-based pricing. He is also an Adjunct Professor & Research Fellow at the Case Western Research University Weatherhead School of Management. He is a Certified Pricing Professional (CPP), a Prosci® certified Change Manager, a certified Price-to-Win instructor, and a Strategyzer Business Model Innovation Coach. He has authored six books: ***B2G Pricing*** (2020), ***Monetizing Data*** (2018), ***Value Mindset*** (2017), ***Dollarizing Differentiation Value*** (2016), ***The Pricing Journey*** (2015), and ***Pricing and Human Capital*** (2015). Stephan sits on the Advisory Board of LeveragePoint Innovation and of the Professional Pricing Society. Liozu will also lead a workshop on ***"Value Realization: Your Next Competitive Advantage"*** at the PPS Spring 2022 Pricing Workshops & Conference in Chicago on April 27.

There is a consensus among scholars, consultants, and practitioners: value-based pricing is a progressive and customer-centric pricing methodology. It focuses on the customer's needs, the customer's perceived value, and the customer's willingness to pay. I started researching value-based pricing in 2008 one year prior to embarking on my Ph.D. journey. I had some experience with the approach, but I did not fully grasp the complexity of designing and executing it across an entire organization. Since then, I have researched value-based pricing, experimented with variations of it, and executed it multiple times. Every project I have worked on is different, challenging, and feels like a learning experience. To this day, I remain convinced that value-based pricing is not for every organization and that it is impossible to deploy it in its purest form. There are always adaptations, exceptions, and sacrifices to make.

As a value-based pricing consultant, I am often approached to help organizations get started. I run into leaders who are willing and eager to start the hard value and pricing work. They often start with some training and a mini-pilot project. They quickly realize that it is harder than they thought for a variety of reasons. They reflect, regroup, and then do something else! The methodology is straightforward to understand, but its implementation runs into severe organizational and external headwinds. It brings me back to the fact that not every company is going to require value-based pricing, be ready for it, or be mature enough to deploy it.

Before getting started with the deployment of any value-based pricing activities, I propose that there are five areas to explore and some basic activities to conduct prior to experimenting. Let us review them one-by-one:

1. **Heavily socialize concepts of value and pricing across the organization:** because value-based pricing is much more than a pricing strategy and because it touches all go-to-market functions, there is a large amount of socializing on the methodology and approach that must be completed internally. All relevant functions (sales, marketing, pricing, finance, technical, application engineering, and others) must be exposed to some basic knowledge and information about the topic.

a. Collect industry and peer benchmarks: what are companies in your ecosystem working on? Are there companies already focusing on value-based strategies? Looking at your key industry verticals, are there consulting or industry reports focused on value and pricing?

▶ CONTINUED ON PAGE 2

b. Introduce basic pricing and value concepts: it is essential to inject basic concepts of pricing and value across the organization through an intentional socialization program. You can work with your training and development team on this or do it yourself as you interact with the teams. Bring the outside in and invite a couple of guest speakers at your next pricing meeting. The key is to start having discussions internally about both topics.

c. Evaluate the appetite through the leadership chain: are your leaders interested in making a change in pricing orientation? Is there an appetite for change in the C-suite?

d. Articulate and evaluate an intense sense of urgency: gather some of the pains the business is experiencing to prepare a business case for change. Gather industry statistics on the impact of value-based pricing and connect that to your organizational pains. Be ready to use that when leadership asks you for your opinion.

2. **Conduct a thorough value-based pricing readiness assessment:** this is an essential exercise prior to doing anything. There are prerequisites to starting value-based pricing and the need for data is great. I have developed a value-based pricing readiness assessment organized around the six steps of the methodology that can highlight some of the strengths and weaknesses that you must address during your project planning.

a. Establish the baseline of where you stand today: know where you are starting from and track progress by repeating the assessment every 12 to 18 months. Showing you are succeeding is important. Make effective use of a pricing dashboard to promote progress.

b. Prioritize action based on current maturity: start with the critical part of the process and the critical gaps. Slow down until these gaps are filled. Do not try to do too much at once.

c. Study your internal capabilities: there are certain capabilities you cannot do without. If your team does not understand concepts of customer segmentation or competitive analysis, you will need to develop these muscles before you can get started. That takes time and effort, but it is worth the investment.

d. Design a project scope that you can manage: this is an area in which I see too many mistakes. Some leaders try to do too much at once and they develop a scope that is too big for a first effort. Make sure you size the scope of your first project correctly. It needs to be the right project to show the right success story. It also depends on the result of your maturity assessment. If your organization has the right maturity, then you can scope and scale faster. If not, take baby steps and slowly increase the scope of projects over time.

3. **Fully understand your industry dynamics:** some industries are more competitive than others. Industry structure and dynamics play a critical role in enabling or stopping value initiatives. You must understand your place in the industry to gauge whether or not you are in an advantageous position to become a value player.

a. Customer consolidation: if your customer base is extremely consolidated, it might be difficult to quickly transition to a value-based pricing approach. These customers have power, and they might dictate the type of pricing they want to see. You might still be able to use value-based pricing for innovations or services, but powerful and large customers typically act like professional buyers with strict guidelines.

b. The role of trade channels: doing value-based pricing when you deal with trade channels can be challenging. You have to do twice the work. You must bring channels on board and have dedicated value programs for them. They can function as value bottleneck and stop you from pricing on value to the end customers. That requires a dedicated channel approach.

c. Competitive landscaping: before embarking on value-based pricing, you also need to be sure you are in a competitive position to do so. What is your industry structure? How many competitors do you have? How many of them are price-focused competitors? I recommend the preparation of value maps to gauge the current position you occupy in the competitive landscape. If you operate in a competitive environment where price wars are a regular occurrence, it might be difficult to be the only supplier moving to a value-based approach. Going at it alone is courageous, but you need to know if you can stay in the game for the long run as your volume levels might decrease.

d. Relative pricing power: it is equally important to gauge

▶ CONTINUED ON PAGE 3

your current level of pricing power. Have you been able to make a price move in the past? If so, what was the impact on sales volume? Some industries are extremely price-sensitive, and any variations in price lead to changes in volume. You might have to start value-based pricing programs with new products or services and leave the core alone at the beginning.

4. **Evaluate your level of operational excellence:** one of the key prerequisites of transforming towards value-based strategies is having outstanding operational excellence. Anything short is an open door for issues with your customers, especially with their procurement teams. They will be the first ones to remind you that you have issues and you do not deserve the premiums they pay.

VALUE-BASED PRICING REQUIRES DISCIPLINE IN EXECUTION. DELIVER WHAT YOU PROMISED AND EXTRACT THE PREMIUM YOU DESERVE

a. Supply situation versus competitors: if you have very long delivery lead times versus your competitors, you will have to account for this in your differentiation analysis. Remember that value-based pricing considers your true positive and negative differentiation. You need to be realistic and transparent in showing your true relative position.

b. Operational performance of your current offers: are your products and services truly differentiated? Do you have performance issues during the installation or the deployment phases? Quality and program issues are detrimental to the successful deployment of value-based strategies. Buyers are good at gathering these incidents and documenting them for your next visit. They will ask for compensation.

c. Overall level of customer satisfaction: many of your customers have scoring mechanisms for their vendors. They track key performance indicators and publish reports on a quarterly basis. How good are your net promoter scores and customer satisfaction scores?

d. Perceived performance on value intangibles: in some industries where products might be commoditized, the differentiation comes from intangible value drivers. Some of these drivers include ease-of-doing business, levels of innovation, longevity in business, degree of partnership orientation, etc. Intangible value drivers in some cases surpass tangible ones in the customer ranking.

5. **Think about getting better at doing pricing the way it is done now:** is value-based pricing the first thing you should implement within your organization? That is a key question. Besides conducting a value-based pricing readiness assessment, have you conducted a pricing capabilities assessment to understand when you are in your pricing maturity journey?

a. Review your current pricing process: before starting on a value-based pricing program, focus on fixing your current pricing process. If you are doing cost-plus or competition-based pricing, do that better. Improve your pricing discipline by fixing your discounting guidelines while slowly socializing concepts of value. I find that this is a much better way to get started with a pricing project.

b. Study basic pricing KPIs: develop a basic pricing dashboard to evaluate your short-term profit leaks. Address these leaks right away to improve business performance.

c. Establish pricing guidelines through a task force: work with finance at establishing new pricing guidelines that can be deployed in the pricing process and with the salesforce in a matter of few weeks.

d. Show impact with a ninety-day rolling action plan: showing short-term pricing impact is a strong and rational way to get started. It puts pricing on the map with top leadership and opens the door for further discussions on what could be done. For many executives, value-based pricing is very theoretical, and they cannot understand the short-term impact. Focus on making an impact with pricing first and then convince them that you can do much more.

There is a reason only 20 to 25% of companies have embraced and integrated value-based pricing as a primary pricing orientation. Many companies tried, failed, or stopped. Others have been on a journey for many years. These value-based pricing champions have adopted and integrated some imperfect form of value-based pricing. It is all right. There is not a right or wrong pricing approach. There is no

▶ CONTINUED ON PAGE 4

perfect pricing method either. Value-based pricing is dynamic, advanced, and challenging. It is not for every company. Before you officially put this methodology in your pricing roadmap, make sure it fits well with the activity sequence, with your industry dynamics, and with your culture. If not, focus on other pricing initiatives first. There may be a better time or a better set of conditions to get started.