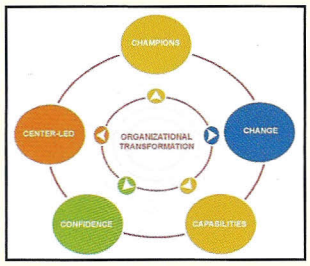
Making the Business Case for Investments in



Pricing research has consistently pointed out the effectiveness and unique strengths of the value-based approach to pricing. However, despite the advantages of this method, a comparatively small percentage of firms have adopted this strategy. In this article, the author explains common organizational barriers to adopting value-based pricing, and also suggests methods for overcoming these challenges to implementation. **Stephan Liozu, CPP is President & CEO of Ardex America Inc (www.ardexamericas.com), an innovative and high-performance building-materials company located in Pittsburgh, PA. He is also a PhD candidate in Management at Case Western Reserve University, a frequent PPS instructor and presenter, and can be reached at sliozu@case.edu.**

Of the three main approaches to pricing in industrial markets cost-based, competition-based and value-based the latter is considered superior by most marketing scholars (James C. Anderson, Wouters, & van Rossum, 2010; Hinterhuber, 2004; Ingenbleek, Frambach, & Verhallen, 2010) and pricing practitioners (Cressman Jr, 2010; Forbis & Mehta, 2000). Paradoxically, few firms have adopted it. A meta-analysis of pricing approach surveys between 1983 and 2006 reveals an average adoption rate of just 17% (Hinterhuber, 2008b). Cost-based and competition-based approaches still play a dominant role in industrial pricing practice.

There are many published reasons for the low adoption of value-based pricing. Scholars focus on the difficulty of defining value and the lack of market orientation (James C. Anderson, Jain, & Chintagunta, 1993). Practitioners often mention issues with value assessment, internal communication breakdowns between marketing and sales teams, and the lack of incentive alignment (Cressman Jr, 2009; Hinterhuber, 2008a).

One of the least-mentioned barriers to the increased adoption of value-based pricing is the difficulty of measuring and selling the required investment and the return on investment internally. While the role of champions at the top is a key to a successful implementation (Liozu, Boland, Hinterhuber, & Perelli, 2011), it is still very difficult to justify the investment for value-based pricing to top management in the C-Suite. What are then the roadblocks leading to this difficulty?

Difficulty in Scope Definition

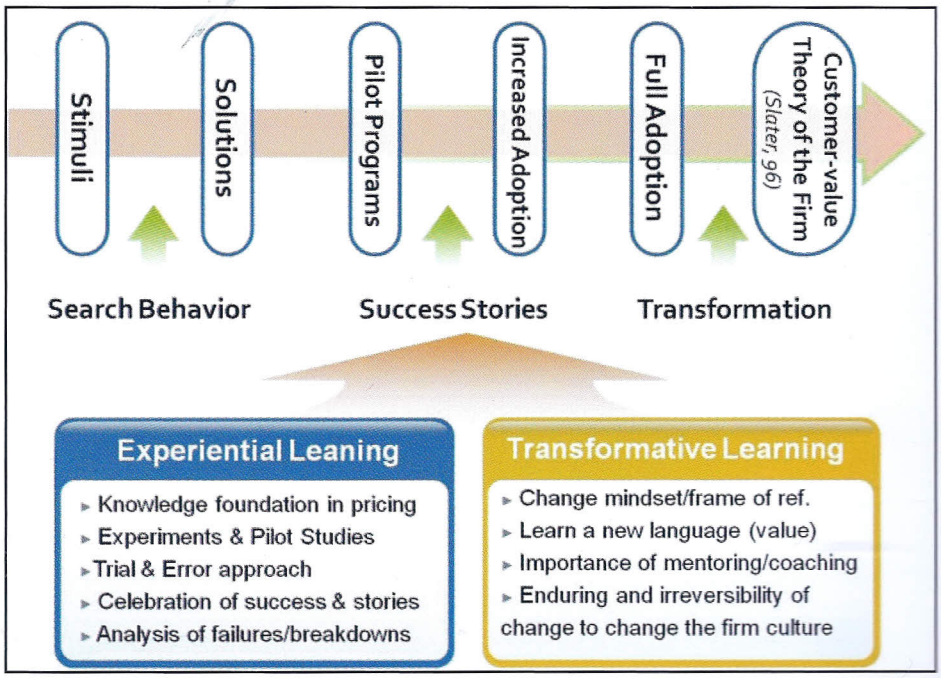
The first possible difficulty lies in defining the scope of the value-based pricing concept. What are the relevant programs, activities and costs? A recent academic paper published in January 2012 in the Journal of Revenue and Pricing Management reveals the difficulty in conceptualizing value-based pricing. Practitioners create their own social construction of the method and include what is needed based on their current context. This contextual framing is dynamic in nature. Therefore, the scope of value-based pricing will also vary based on progress along the journey, changes in the market dynamics and progress in pricing theories.

Long Transformational Journey

The study of the adoption and deployment of value-based pricing reveals that it is a long journey that can last anywhere from 3 to 7 years. This journey requires an organizational mobilization that is the equivalent of a deep organizational transformation.

Because of the unknown length of this journey, it can be difficult to analyze and project its exact duration. Some firms will spend more time in the experimentation phase to create the number of successful case studies necessary to maximize buy-in (J.C. An-

Figure 1



derson, Kumar, & Narus, 2007; Liozu, et al., 2011). But, generally speaking, firms never reach the terminal status of successful implementation. Achieving value-based pricing implementation requires constant investment in pricing, continuous innovation in pricing, and significant investment in training as the organization integrates new businesses and personnel. Knowing when to stop the investment "meter" is a real challenge. This also complicates the process of defining the scope of value-based pricing implementation.

Benchmarks and Case Studies Are Not Enough and May be Misleading

Firms internalizing value-based pricing go at various speeds and with various intensities. The nature of their programs is also adapted to their environmental context and their existing internal capabilities. External benchmarks typically consist of qualitative case studies available through the Professional Pricing Society, other practitioner organizations or consulting firms. Conducting benchmarks of successful transformation can help, but it does not provide the necessity rationale and scientific support. Benchmarks encourage imitations (Pfeffer & Sutton, 2006) and copy/paste behaviors (DiMaggio & Powell, 1983) that can be detrimental to the accuracy of the project cost evaluation.

Lack of Documented Success of Value-Based Pricing Performance

Most pricing practitioners agree that the lack of scientific and systematic ROI calculations for pricing strategies constrains the visibility of pricing in the corporate executive suite and restrains firm adoption of modern pricing approaches. In addition, the marketing and pricing literatures are silent about both the effect of firm pricing orientations on overall company performance and, more specifically, about how modern pricing practices might lead to superior firm performance (Hinterhuber, 2008b; Liozu, et al., 2011).

This silence impedes the ability to quantitatively and statistically demonstrate that firms using value-based pricing deliver superior sales, pricing and profit performance. The lack of academic research on this direct link makes it virtually impossible to convince CEOs and other C-suite executives who get bombarded with economic and financial analysis. The case for value-based pricing is typically based on qualitative case studies and incomplete data, leading to reduced credibility.

Bottom line: Justifying investments with top executives in value-based pricing is not easy. It requires a thorough understanding of what the transformation requires and a clear delineation of the value-based pricing scope. There is no silver bullet or template to recommend; however, consider the following ideas to make the case a stronger one and to get attention from top leaders.

Include Costs Associated to All Organizational and Behavioral Programs

Based on the transformational nature of the implementation, experts recommend breaking the value-based pricing story down into several modules or sub-projects. These modules might be based on the 5-C model I recently presented at the last Professional Pricing Society annual conference and shown below (champions, capabilities, center-led management, change and confidence).

They should include change management programs and confidence building initiatives, which are essential to increasing the level of organizational commitment and organizational self-esteem. Value-based pricing is a real transformation of the firm DNA from cost or competition to value (Forbis & Mehta, 1981; Liozu, et al., 2011). Besides typical costs of building capabilities (models, software, tools, pricing training, market research, etc), firms will have to think holistically and include all relevant costs. Including these activities will increase the budgeting and planning process in building the business case.

Create a Formal Pilot Program and Make the Case for Increased Scope

Another very good option is to voluntarily reduce the scope of the value-based pricing project and to focus first on one or two

Figure 2

pilot projects in a region, a business unit or a product line. Narrowing the scope of the case in the short term will reduce the uncertainty associated with an entire organizational transformation. The relevant costs will be easier to calculate. Choosing a "friendly" region or business unit led by a champion who is aware of the potential positive impact of value-based pricing will open the door for more collaboration and support to create a powerful financial case to be presented to upper management. Having the regional or business unit leader on board from the get-go will help justify the project.

> Investments in value-based pricing do not pay off quickly.

Define Specific Value-Based Pricing KPIs in the Business Case

A critical element of the business case is the definition of clear, relevant and quantitative KPIs for tracking success. These need to be specific to the value-based pricing implementation. Top executives need to be reassured that progress will be measured and that success will be reached. Having the right cockpit included in the business case will tell the story of "how do we win?" "how do we know when we are done?" or "what defines success?" types of questions. These KPIs might include number of trained people, pricing realization index, incremental pricing with new products, etc.

Diagnose Where You Stand on the Pricing Maturity Model

The most important question to be asked before preparing the business case for significant investments in value-based pricing is "What is the existing level of pricing maturity?" Understanding where the organization stands in the price maturity model is important to defining the scope of the project and the intensity of the required investments. Some organizations may require significant initial training programs to bring everyone in the organization to the same level. Others may require up-front investments in systems and tools. Therefore, conducting a diagnostic of the current pricing capabilities is primordial and must be included in the overall business case. Before one knows where to go and what is needed, one needs to know where one stands!

Bring the Outside In to Showcase Successful Transformations

Over the past 12 months, I have talked to many management teams and have explained to them what is needed to take the journey towards value-based pricing. Inviting thought leaders who have no commercial interests can bring a candid and transparent understanding of the required investments and necessary steps to get started. During these one- to two-hour sessions with executive committees, I was able to explain the 5-C model of that transformation and the need to understand "short-term pains for long-term gains." Investments in value-based pricing do not pay off quickly. Payback periods for these transformational investments are longer than those for traditional investments. Bringing the outside in generates more pragmatism and realism in the value-based pricing story, which, sometimes, can be subjective, vague and difficult to grasp.

Over the past three years, I have been conducting academic research in the area of value-based pricing and pricing excellence. My intention is to demonstrate academically and statistically that adoption and internalization of value-based pricing leads to superior firm performance. Additionally, I have designed a quantitative study to validate that the 5-C model can also lead to superior profits. Over the coming few years, we will continue to launch short academic surveys to explore the academically neglected field of pricing and to bring knowledge to the pricing community that can be elevated to the C-suite. Let us build a strong story to create awareness, convince C-level executives about the power of value and pricing management, and make the internal business case justification process smoother and faster.

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