Measuring and Communicating the ROI and Impact of Pricing

The purpose of this short article is to briefly discuss some of the difficulties pricing practitioners encounter in calculating ROIP (ROI of pricing) and to recommend ways to get started, to increase the chances of calculation success, and to see the value of the pricing function internally. Stephan Liozu (www.stephanliozu.com) is the Founder of Value Innoruption Advisors, a consulting boutique that specializes in disruptive approaches in innovation, pricing, and value management. He is also Assistant Professor of Strategy and Management in the Business and Entrepreneurship Department at Chatham University. He earned a PhD in Management from Case Western Reserve University. He co-edited the book "The ROI of Pricing," published in 2014. He can be reached at sliozu@gmail.com.

Measuring the impact of pricing has become a priority for many pricing teams who compete with other functions and processes for investments and management's attention. Pricing professionals understand the need to make the case for these pricing investments and to justify their existence.

There are many discussions, but in practice the calculations are difficult. A recent study with over 300 pricing professionals on the topic of the ROI of pricing (ROIP) revealed that although 70% of them considered calculating ROIP to be important, only 33% formally calculated it in their organizations. Whether the calculation was performed formally or informally, no respondents rated very highly their ability to extract and measure the impact of pricing.

Whether because of a lack of science or knowledge related to ROIP calculations or a general lack of skills in the area, the pricing profession does not compete well with manufacturing and R&D, which traditionally have more experience securing investments and management attention. My experience shows that a $100,000 investment in manufacturing assets might fall into the discretionary investment budget, whereas the same investment in pricing software might require far more convincing and sweat equity.

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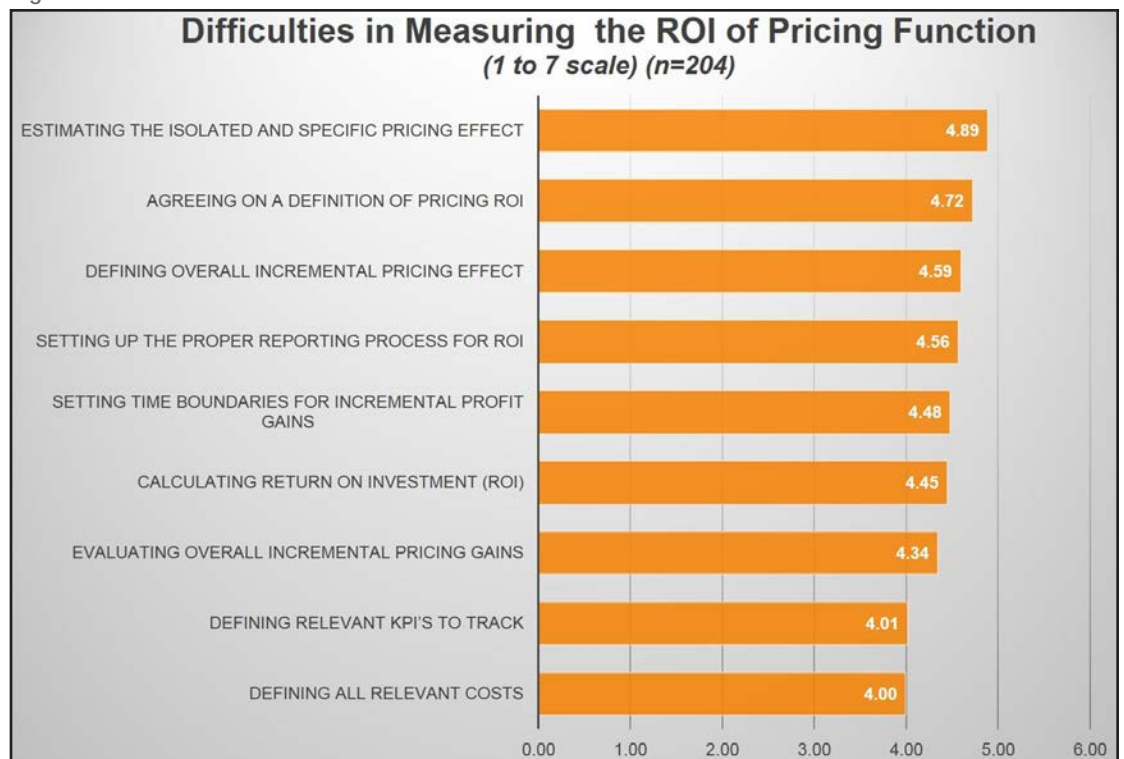
Issues Encountered in Calculating ROIP

Many factors can affect the ability of a team or a pricing professional to calculate ROIP. Some of these might be related to a lack of access to data or pricing's not yet being recognized as a full-fledged function. Finally, there is a general lack of science on the topic of ROIP, which limits the exploration of the topic within the pricing profession.

In the 2012 ROIP survey, respondents rated estimating the isolated effect of pricing as the most difficult task when measuring the impact of the overall pricing function, as shown in Figure 1 (scale of 1 to 7, with 1 = *very simple* and 7 = *very difficult*). This

Figure 1

Difficulties in Measuring the ROI of Pricing Function
(1 to 7 scale) (n=204)

ESTIMATING THE ISOLATED AND SPECIFIC PRICING EFFECT	4.89
AGREEING ON A DEFINITION OF PRICING ROI	4.72
DEFINING OVERALL INCREMENTAL PRICING EFFECT	4.59
SETTING UP THE PROPER REPORTING PROCESS FOR ROI	4.56
SETTING TIME BOUNDARIES FOR INCREMENTAL PROFIT GAINS	4.48
CALCULATING RETURN ON INVESTMENT (ROI)	4.45
EVALUATING OVERALL INCREMENTAL PRICING GAINS	4.34
DEFINING RELEVANT KPI'S TO TRACK	4.01
DEFINING ALL RELEVANT COSTS	4.00

isolation mechanism is critical to measuring the impact and ROI of pricing but also to being able to respond to the objections of other functions, who typically take credit for improvements to the top or bottom line. This has to be an area of focus for the profession if its members want to increase their sophistication in this exercise. Methodologies exist for isolating the incremental impact. One of these is the Six Sigma process. Another is the design of controlled experiments. Statistical methods for tracking and measuring the increased effect are also available.

The ratings of the difficulties in measuring the ROI of the pricing function listed in Figure 1 clearly show that nothing is simple when it comes to ROIP. Because pricing actions and activities are conducted in a highly dynamic environment, it is difficult to isolate the moving parts so as to apply the ROIP formula. Pricing professionals also seem to struggle with defining relevant key performance indicators (KPIs) to track.

Difficulties in Measuring The ROI of Specific Pricing Activities (1 to 7 scale) (n=204)

Activity	Rating
DEFINING OVERALL INCREMENTAL PRICING EFFECT FOR INITIATIVES	4.29
SETTING UP THE PROPER REPORTING PROCESS FOR ROI	4.28
AGREEING ON A DEFINITION OF PRICING ROI FOR INITIATIVES	4.27
ESTIMATING THE SPECIFIC PRICING EFFECT OF INITIATIVES	4.25
CALCULATING THE ACTUAL RETURN ON INVESTMENT (ROI)	4.21
EVALUATING SPECIFIC INCREMENTAL PRICING GAINS	4.16
DEFINING ALL RELEVANT COSTS FOR SPECIFIC PRICING INITIATIVES	3.83
DEFINING THE SCOPE OF PRICING INITIATIVES	3.83

When asked the same question but with respect to specific pricing activities, respondents also rated defining the overall incremental pricing effect as the most difficult element to track, as shown in Figure 2. Equally difficult, they said, is establishing a proper reporting process for ROI and agreeing on a definition of pricing ROI.
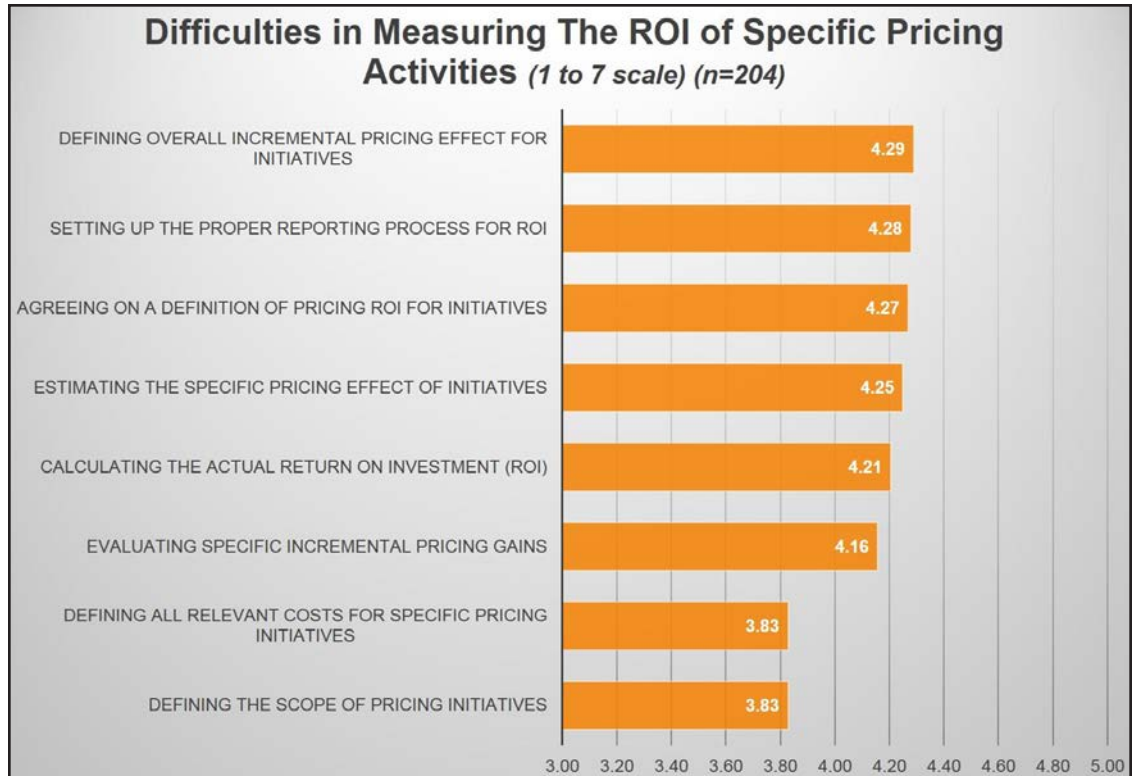
Because of the narrower nature of pricing activities, respondents seem to consider the definition of relevant costs and of the initiative scope to be a bit simpler.

Practical Recommendations for Getting Started with ROIP

Calculating ROIP is not easy, as the respondents' feedback shows. It is important to keep in mind the barriers and limitations involved and to leverage them to create a process that works. We propose the following sequence of actions in order to maximize the chances of success:

1. Jointly agree on the definition of ROIP (formula, data source, scope, and timing): This can be done with support from finance as part of the pricing council or as part of a separate task force. All relevant stakeholders must participate in these initial discussions and in reaching consensus. One way to get started with this is to search for available definitions of ROIP and to benchmark internally how your organization defines the ROI of other functions such as R&D, innovation, and manufacturing. Then you can apply this internal standard to ROIP.

2. Implement the measurement and tracking mechanism (ownership, frequency, reporting): Once the critical components are agreed upon, the next step is to design the process for who does what and how often. Pricing must take the lead in this process and assemble the best team to get the process going. There are potentially dozens of KPIs to measure and track. Besides a pure ROIP for specific pricing programs, do not try to boil the ocean by reporting too much in a pricing dashboard. How you report pricing KPIs and what you report are equally important. Find the most compelling KPIs for business executives. Make sure to work closely with your finance and IT teams to extract the right data religiously and systematically. Take a close look at averages as well as extreme outliers that might bias your measurement levels.

3. Use statistical methods to extract the positive effects of pricing actions: Using the proper methods to calculate the effect and impact will bring confidence from the team that the ROIP is accurate and not coming from a "black box." Although I don't recommend that you volunteer long explanations of how your ROIP was calculated in total or by strategic pricing action, you should have the explanation ready at any time. Statistical analysis is not for everyone unless your audience is very analytical. If your numbers get challenged by business executives, prepare a calculation rationale in plain English that is widely accepted by your finance friends.

4. Jointly agree on the outcome of the measurement and the special circumstances: The work is not done once you've extracted the ROIP or the specific isolated impact. The scientific data must be reviewed in a team format and agreed upon. Special cases and circumstances must be reviewed and agreed upon. This is where change management skills are needed to maintain the coalition and avoid frictions when reviewing the results. The

team has to be reminded that this has to be a win-win for all participants in the project and that it is not a finger-pointing exercise. The main issue arises when results do not match expectations. The normal reaction will be to reject the measurement formula or the scope of the calculation. Pricing professionals have to stay the course here and maintain that strong coalition. They must also focus on executing the pricing projects rather than on measurements and ROI. Measuring ROI is not a performance outcome. Moving the profit needle in the right direct is.

5. Report ROIP to all stakeholders (pricing council, top management): The final step in the process is to promote the specific impact throughout the organization to promote the pricing discipline and to shine a light on the collaborative measurement process. Whether or not the measurement is matching expectations, pricing professionals have to report ROIP consistently to ensure that top executives follow long-term trends and contributions. The monthly or quarterly report should emanate from the pricing council or the pricing committee if you have one or the other in your organization. These reports should be in the form of a simple and short report highlighting a visually attractive dashboard. I do not recommend sending a long report full of pricing statistics—it might not be read! Think about a top executive bringing a handful of documents to read on a plane. Prepare for 15 to 20 minutes of attention. Go to the essential and visually direct the attention of your business readers.

This process highlights the need for an increased focus on the science and the process of ROIP calculation. Other elements are equally important to the promotion of ROIP, and these are more qualitative. I list five below:

▪ **Make it a process:** Calculate the impact and ROIP of pricing for each project before starting the project. Show top management that your pricing team is serious about measuring its impact and that every project will have to make sense and deliver a certain level of ROI.

▪ **Under-promise and over-deliver**, and not the other way around. I recommend spending a fair amount of time defining the scope of the project and establishing expected contributions with all relevant stakeholders. It is already very hard to secure investments in pricing. Under-delivering once or twice might make it even more difficult in the future.

▪ **Learn from successes and from failures:** Jack Welch was very clear about this one. It's okay to make a mistake and to fail. But make sure not to repeat the failure a second time. Regardless of whether pricing projects are successful (i.e., you are achieving the expected ROI), list lessons learned and ways to improve for the next pricing project.

▪ **Take clear ownership of the process:** The pricing function has to take clear leadership and ownership of ROIP calculation. The team might be cross-functional, but pricing needs to be accountable for the entire process. Do not let this go to sales or finance, as often happens.

▪ **Culture eats strategy for breakfast:** Establish a culture of accountability in your pricing team. Get your pricing experts trained on the essentials of ROIP calculation, on how to promote

pricing impact internally, and on how to use change management principles to get a broad coalition to support the initiatives.

Bottom line: measuring the impact and ROI of pricing requires both scientific knowledge and social skills. Plenty can go wrong; the process is complex and dynamic. Please avoid making the easy mistakes. Here are several presented in a straightforward manner.

Figure 3

The Don'ts of ROIP Measurement
- Do not measure ROIP in a **silo** → Build a broad coalition.
- Do not make the process **too complicated** → Simple is better.
- Do not **overwhelm** top management with statistics → Story line.
- Do not make the report **boring** →Use colors & visuals.
- Do not measure ROI for a **10 year project**! → Break it down.
- Do not **forget** change management → Bring every one on board.
- Do not **overpromise** and under deliver → Manage expectations.
- Do not **repeat** the same mistakes twice → Learn from failures.
- Do not **argue** on who is getting the credit → Share credit widely.
- Do not **start** a pricing project without ROIP targets → accountability

Besides ROIP Calculation:
Promote the Pricing Function Internally
Over the past few years, I've met hundreds of successful pricing professionals working for great organizations. Many of them do a fantastic job at measuring the ROI of their pricing projects. However, many still suffer from a lack of internal credibility despite demonstrated impact on the bottom line. I posit that it is essential to calculate ROIP.

It is equally essential to internally promote the contribution of your pricing function just as other functions might do regularly. This is where it might be very useful to benchmark how innovation teams, process improvement teams, and supply chain teams do it. Mindfully promoting your team success brings visibility and credibility to your work. It also educates top leaders in your organization about what you're doing and how you contribute to the organization's mission. Here are some tips to consider when doing so.

1. Conduct *internal assessments* with the business groups you support and the key decision makers you interact with. If you consider these folks as your internal customers, then your conducting an internal customer satisfaction survey might be well received. You could do this either by using qualitative interviews or by conducting an internal quantitative survey if you work for a large organization and if your team touches a large number of users. Report the findings to these top leaders and link actions and improvement plans to your long-range functional planning process. Conduct these assessments to track your progress in meeting your internal customers' needs. Use them to collect insights about their future needs.

2. Conduct *formal reviews* of closed projects as many IT teams do. They conduct "post mortem" analyses on all projects that have been deployed. Bring in some of the stakeholders involved in the strategic pricing projects that were recently finished and have them undergo a formal review process. Establish a template for review so that all projects are treated equally. Make sure the

results of these project reviews are documented and shared with the appropriate department heads.

3. Create *powerful stories* about some of the successful projects you have led for your organization. We often cite success stories with external customers as tools to improve the level of pricing adoption in a commercial team. Use the same process internally with some of your best customers. If a pilot project was successful, create a project success story to share with all business groups. Use your internal website to ensure that the story gets promoted internally. Accustom the organization to reading about the success of your pricing initiatives, whether success is defined by numbers or by more qualitative information.

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4. Invest in the development of your *functional value proposition.* Ensure that each member of your pricing team is equipped at any time with the right value elevator speech. Make sure they can answer the typical CEO question: "What do you do for us?" or "How do you personally contribute to the success of our organization?" You should never be caught by surprise with these questions. An internal-value elevator speech for your pricing team will also list why internal customers should choose you and work with you. Be specific about the deliverables you bring to the organization and have two or three success stories ready.

5. Create *dramatic statistics* about your pricing function. I have seen few teams do this in a regular and compelling manner. Dramatic statistics help remind internal stakeholders of the importance of the pricing team in managing the organization's pricing operations. Here are some examples:

- "Every month, we manage 5 billion line-item pricing conditions across five continents and 7,500 active customers."

- "We manage pricing conditions for over 1 million SKUs."

- "Since 2010, we have contributed $350 million in accumulated incremental profit for the organization. This contribution has been validated internally by our finance department."

- "Every member of our pricing teams generates an annual contribution of $1 million in incremental profit through our portfolio of pricing projects."

- "Every day, our pricing team touches over 10,000 customer transactions and makes sure our team of 2,500 sales representatives are compliant with our pricing guidelines."

Obviously, these numbers are made up. But I want to consider for a second the impact of these critical statistics. Next time someone in your organization asks you what you do, you might want to use some of these to make a statement. Make sure they are vetted and credible. And do not go crazy with them.

Conclusions

The pricing function in general needs to do better at calculating its ROI and the impact of pricing, day-in and day-out, on the organization. Then they need to better sell their accomplishments internally. Both are needed to improve organizational awareness of what pricing can do for the bottom line. It's not easy to get started. But you owe it to yourself to improve and to help the profession improve its overall status. I am not saying that we all have to turn into selling machines throwing wild numbers to top management. This approach needs to be mindful, realistic, and humble. You might not feel comfortable doing it, but remember that other functions (innovation and supply chain for example) do it successfully and manage to secure a large chunk of investments.