Pricing Strategy
Services Industry

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Topics

• Why pricing is important
• Pricing Maturity Roadmap
• How to define the Pricing structure
• Pricing Process
• Conditions for Pricing Strategy
Why Pricing is important

Impact of price increase on Operating Profit

Improvement in price by 1% increases profitability by 11%

Price is the biggest profit improvement lever

Improving the lever by 1% delivers profit improvement of ...

Price decreases are only offset by huge volume uplifts

Reducing prices by 5% requires a break-even volume increase of 17.5%

Source: The Price Advantage, Marn, Roegner, Zawada
Based on Global 1200 Average Economics
Pricing Maturity Map

Pricing Maturity

Sample Characteristics

- Predictive • Total Value Chain View

Preemptive

- Context-driven pricing

Adaptive

- Pricing based upon perceived market conditions

Reactive

- Cost-based pricing

Primitive

Low

Cost to Implement

High

Low

Profit Impact

High
How do we define the Pricing Structure?

Structural Elements

- Metrics
- Packaging
- Usage

Detail Elements

- Levels
- Discount
Aligning Metrics

• Metric = On what basis you charge the customer
  ▪ Critical, fundamental
• Scale with value delivered
  ▪ People Per user
  ▪ Deployment Per instance
  ▪ Web access Per transaction
• Depends on how product is used
  ▪ Personal vs. group use
  ▪ Transaction vs. continuous use
  ▪ Sporadic use vs. frequent use
• Selection considerations
  ▪ Convenient for budgeting, quoting
  ▪ Easily monitored and measured
    – Must be instrumented properly
    – Basis for billing, invoicing
### Example of Metrics – Services Industry

<table>
<thead>
<tr>
<th>Service</th>
<th>Measure</th>
<th>Vendor</th>
</tr>
</thead>
<tbody>
<tr>
<td>CRM</td>
<td>per sales rep</td>
<td>RightNow, Salesforce.com</td>
</tr>
<tr>
<td>Developer Tools</td>
<td>per instance</td>
<td>SAP, Oracle</td>
</tr>
<tr>
<td>Stock Trading</td>
<td>per trade</td>
<td>Archipelago</td>
</tr>
<tr>
<td>Credit Card Processing</td>
<td>% of transaction</td>
<td>Verisign</td>
</tr>
<tr>
<td>Survey</td>
<td>per survey</td>
<td>Zoomerang</td>
</tr>
<tr>
<td>Check Scanning</td>
<td>per check</td>
<td>Kodak</td>
</tr>
<tr>
<td>Network Management</td>
<td>per device</td>
<td>Hewlett Packard, Cisco</td>
</tr>
<tr>
<td>Insurance</td>
<td>per policy</td>
<td>Allenbrook</td>
</tr>
<tr>
<td>SW asset management</td>
<td>% of revenue</td>
<td>Flexera</td>
</tr>
<tr>
<td>Bandwidth/data transfer</td>
<td>per GB</td>
<td>Comcast, TWC</td>
</tr>
<tr>
<td>Direct Mail</td>
<td>Mail list size</td>
<td>Constant Contact</td>
</tr>
</tbody>
</table>
Packaging

• Basic issues
  ▪ What use cases are being addressed?
  ▪ How are functions related?
  ▪ What functions are popular?
  ▪ Which functions will customers pay more for?

• Narrowing the choices
  ▪ Broad vs. narrow appeal
  ▪ Basic vs. premium offering
  ▪ Add-ons and options
Packaging – Determining Package and Add-ons

<table>
<thead>
<tr>
<th>Component Value to User</th>
<th>Usage of Component</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>Low</td>
</tr>
<tr>
<td>Medium</td>
<td>Medium</td>
</tr>
<tr>
<td>High</td>
<td>High</td>
</tr>
</tbody>
</table>

- Table Stakes
- Features
- Hacks
- Add-Ons
Usage

- Related to payment stream
  - Annual and shorter-term
    - Rate of change in application, use
    - An option? (vs. perpetual)
    - SaaS includes RTU and M&S?
  - Multi-year
    - How long?
    - Payment in advance
    - Price protection typical
- Perpetual
  - Up-front = PV of what?
  - Value of annual M&S?
    - Is % RTU fee (list or net) right metric?
Price Levels - Value-Driven

• Metric tracks value
• Look at ROI, payback period, etc.
  ▪ Target value to be 5 – 10x price
• Price scales with NET value
• Set price for base product using
  ▪ Customer value
  ▪ Competition
  ▪ Costs (for viability)
Price Discounts

• Long lasting financial impact
  ▪ Avoid price cuts
  ▪ Free “months” vs. lower price
• Be clear on objectives
  ▪ Product trial
  ▪ Quick adoption
  ▪ Retention
• Use scheduled discounts
• Avoid negotiated discounts if possible
Discount Types

- Introductory
  - Accelerate new product uptake
- Time-limited
  - Purchase sooner
- Contract length
  - Longer commitment
- Bundle
  - Increase transaction value
- Volume-based
  - Increase unit or dollar volume
- Upgrade
  - Trade-up, upsell
- Segment focused
  - Industry, customer type
Price Setting (Pricing Team)

Standard Cost Setting & Resetting (Finance, Engineering)

Pricing Tools

• Solution development
• Service Descriptions
• Deal profitability
• Sales pursuit review

Develop Deal Price (Sales Support)

Finalize Deal Price (Region Leader)

Deal Sign-Off (Account Executive)

• Contract signed and input into system
• Hand-off to Delivery

Understand Customer
Validate Opportunity
Develop Proposal
Negotiate & Close

Deliver to Sold Price

Apply and Configure Pricing

Establish Standard Pricing

Translate Market Pricing

Plan

Design

Build

Launch

The Pricing Process

Standard Pricing Development

Market Intelligence (Competitive Intelligence)

• Pricing Trends
• Competitive Market Benchmarking

• Provide pricing insight
• Price performance

Product Strategy (Product Management)

Regional Validation (PM, Regional Sales)

Pricing Strategy & Structure (Pricing Team)

Pricing Units
Pricing Structure & Strategy

• Pricing Rules
• Segment Pricing
• Discount Structure

Price Setting (Pricing Team)

• Deal Price Capture and Analysis (Pricing Team)

Standard Pricing Development

Transaction Pricing

Product Strategy

Regional Validation

Price Setting

Pricing Tools

Develop Deal Price

Finalize Deal Price

Deal Sign-Off
## Key Pitfalls to Pricing Process

<table>
<thead>
<tr>
<th>Pitfalls</th>
<th>Mitigation Strategy</th>
</tr>
</thead>
</table>
| Pricing Process is not Proactive                                        | • Executive Sponsorship of pricing process  
• Pricing Governance                                                       |
| Does not give an integrated view of all relevant information             | • Having a pricing process that involves key function groups and embeds cross-functional co-ordination |
| Right incentive are not there for salespeople                            | • Right sales incentive structured on sales revenue and profitability                |
| Customer does not understand the differential value of the product offering | • Sales and marketing collateral aligned to justify pricing                          |
## Typical Pricing Strategies

<table>
<thead>
<tr>
<th>Pricing Strategy</th>
<th>Skim</th>
<th>Neutral</th>
<th>Penetration</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Description</strong></td>
<td>• Pricing high compared to competition or pricing higher than perceived value of product or service</td>
<td>• Price close to competition or pricing close to medium than perceived value of product or service</td>
<td>• Price low relative to competition or pricing lower than perceived value of product or service</td>
</tr>
<tr>
<td><strong>Value Differentiation</strong></td>
<td>• Differentiated</td>
<td>• Parity / Slight Disadvantage</td>
<td>• Disadvantage</td>
</tr>
</tbody>
</table>
| **Lifecycle Phase** | • Emerging – Mainstream  
• All Phases – Niche Providers | • Mature & Declining Markets  
• All Phases – Slightly Disadvantaged (“Me Too”) | • Growth |
| **When to Use** | • Ideal to use with high value and image type services  
• Company has a competitive advantage  
• Trying to protect against price competition in Growth and Mature Phases | • Have good competitive pricing data and ability to keep the data current  
• Want to focus on a broad market  
• Companies at a slight competitive disadvantage that want to adopt a “follow the leader” strategy | • Need to maintain market position for companies at a competitive disadvantage |
| **Margin Impact** | • Captures value from differentiated services and / or early adopters in emerging markets | • Pricing is not used as a competitive weapon preserving margin | • Protects margin from reduced price by using volume growth to change cost structure and reduce costs |

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<tr>
<th>Strategy</th>
<th>Mkt. Phase</th>
<th>Emerging</th>
<th>Growth</th>
<th>Mature</th>
<th>Decline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Skim</td>
<td>Strategy for Niche Providers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Penetration</td>
<td>Bad Positioning</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Neutral</td>
<td>Strategy for Slightly Disadvantaged Companies</td>
<td></td>
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</tr>
</tbody>
</table>
Appendix
## Typical pricing models suitable for price maturity levels

<table>
<thead>
<tr>
<th>Pricing Model</th>
<th>Definition</th>
<th>Optimal Conditions for Use</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market Based</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Price</td>
<td>• Project value is determined up front and then divided into installments</td>
<td>• Scope and process is well known</td>
<td>• Software Development projects</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Service provider assumes all financial risk, so use only where risk is low</td>
<td>• Up-sell development when scope is well defined</td>
</tr>
<tr>
<td>Time &amp; Materials</td>
<td>• Project Value is charged for based on consumption of time and expenses as needed to complete the project</td>
<td>• Best for short-term engagements where scope and content is not well-known and the activity is not core to the client.</td>
<td>• IT projects charging monthly or hourly for specified FTEs</td>
</tr>
<tr>
<td>Transactio...n/SLA Based</td>
<td>• Generate price per transaction, multiplied by the number of transactions; usually during a given time period (daily, weekly, monthly).</td>
<td>• Best to use for leveraged offerings where client wants to outsource in order to change their spending from fixed to variable.</td>
<td>• Claims processing for Health Care Companies</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Results are predictable, measurable, clearly linked to the project, and understood by client.</td>
<td>• Reservation systems for airline companies</td>
</tr>
<tr>
<td>Output Based</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Blended (Fixed plus variable)</td>
<td>• Combination of two or more of the above models</td>
<td>• Best to use when there are multiple objectives within the same project, to add flexibility and accommodate different needs</td>
<td>• Consumption-based fixed price includes up to a predetermined number of servicing events (e.g. helpdesk calls), after which additional events are charged for on a per event basis</td>
</tr>
<tr>
<td>Value Based</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk / Reward Business Benefit</td>
<td>• Vendor is paid in proportion to the business value generated by the project or service, such as a percentage of increased profit or decreased cost.</td>
<td>• Best to use when a leveraged offering that can offer significant value to the client</td>
<td>• Pricing of security software services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Must have a strong client relationship; Baseline &amp; tracking the metric for business value is easy</td>
<td>• Supply Chain software implementations</td>
</tr>
</tbody>
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