"This thing called 'price' is really, really important. I still think that a lot of people under-think it through. You have a lot of companies that start and the only difference between the ones that succeed and fail is that one figured out how to make money, because they were deep-in thinking through the revenue, price, and business model. I think that's under-attended to generally."

– Steve Ballmer

Can pricing ever be considered innovative? It depends; simple price points—probably not, complex bundling of product and services into solutions—definitely. This case study illustrates how some in-depth detective work uncovered the root cause of a very emotional organizational issue: How to create a new pricing system that would drive increased revenue. The key to the case was identifying all the moving parts and their interdependencies—a critical step to creating any new competitive pricing architecture.

COMPANY BACKGROUND

The company, for which I worked and this case study covers, is a cloud computing software company (SaaS) that provides a document-sharing service across the Internet. The primary business hosts virtual data and deal rooms, where client companies perform online due diligence. The services offered provide an alternative to physical "brick and mortar" deal rooms. The due diligence materials are used to determine the value and ultimately a bid for merger and acquisition candidates. The company also provided document exchange services and other transaction-related applications for the commercial banking (loan syndication) and pharmaceutical industries (clinical trial support).

THE ORIGINAL ISSUE: "OUR PRICES ARE TOO HIGH"

As the head of Product Management and Marketing, in casual conversations, I was beginning to hear a theme that may have been the reflection of a business problem: individuals in the sales organization felt the company's products and services were not priced competitively, resulting in an unacceptable rate of loss of deals (in SFDC: "Closed—Lost"). A recent series of losses to a primary competitor bolstered this assertion. As pricing is a product management function, it became imperative to examine the corporate pricing methodology to determine if it was in-line with industry practices. Having worked in the past with a sales centric consultant, I brought in The Whitespace Consulting Group to join in the project to help analyze our current pricing model and strategy to determine its worthiness.

MANAGEMENT CONCERNS IDENTIFIED

We organized ourselves as an integrated hybrid inside/outside consulting resources problem-solving team. After conducting fact-finding interviews across the organization, we uncovered the following additional management concerns:

- The sales organization was experiencing an unacceptable win/loss ratio as well as declining revenue. Sales morale was low, resulting in personnel turnover. Lesser deal volume reduced exposure to new users "seats" and the opportunity for cross-sell and up-sell.
- The reduced "uptake" by new customers and loss of user license fees resulted in a reduction in budget for marketing activities in support of new customer acquisition.
- The uncertainty of meeting quarterly financial commitments was negatively impacted the company's financial credibility, limiting our ability to attract new investors for potential additional rounds of funding or an IPO/acquisition opportunity. The company had more than one aborted IPO.

INTERVIEWS UNCOVER ADDITIONAL CONCERNS

- There was no standard set of criteria used to determine pricing; the current pricing architecture was difficult for the salespeople to explain.
- The current pricing methodology was based on a cost-plus model, rather than customer value (ROI) projections.
- The current pricing model discouraged system usage (# seats) making essential "viral" adoption more difficult.
- Additionally, the value and cost of our company's product solutions were difficult to scope and estimate. Delivery costs, including set-up and implementation were difficult to accurately predict. Due to this complexity, management favored a risk-sharing pricing model on the largest deals. This included a management review and approval process for all sales opportunities requesting discounted or nonstandard pricing terms.
- Most of all, the management team wanted the products and services pricing to be simple and easy to understand. Our services needed to be easier to buy than competitive offerings.

DIGGING FOR THE ROOT CAUSE OF LOST SALES

With buy-in from all stakeholders, including other direct reports to the CEO, we recommended an action plan to uncover the underlying cause for the lost sales. First, we conducted a complete win-loss review. Sales wins were analyzed by price achieved and resources utilized. Lost deals were also reviewed and analyzed to better understand the issues resulting in loss. All wins and losses were plotted into natural "clusters" by pricing and deal size, and then further scrutinized.

After the analysis, our team found that, in fact, the sales force was partially right. *There were deals being lost due to price*. However, there were also deals that were completed at a higher price than the competition; apparently our product set, sales relationship and overall brand carried a marketplace premium. The difference in win/loss outcomes was based on deal size and complexity. The majority of deals lost were smaller in both size and complexity. This suggested greater cost sensitivity on the smaller, lower cost deals. In addition, we discovered that the company would realize a net loss if we lowered our pricing on the largest deals in order to win the smaller deals. Any new pricing architecture had to take into account the sometimes difficult to predict, varied implementation costs associated with each deal.

We also discovered that our detailed, bimonthly client usage reporting was enabling, and even encouraging, customers to perform internal and external cost comparison—with our competition, further *commoditizing* our offering. This detailed usage reporting was presented during the sales cycle as a product feature and a competitive differentiator. In many cases, the frequent reporting provided customers with more system usage data than was required or helpful. Customers often utilized the system-usage data provided to perform internal and external cost comparisons and to then justify requests for price reductions from us. These requests undermined the relationship and applied unwanted pricing and margin pressure on both current contracts and future proposals.

OUR RECOMMENDATION: A VALUE-BASED, TIERED PRICING ARCHITECTURE

Our analysis of the sales wins and losses revealed a natural "tiering" of deal sizes. It became apparent that there needed to be a new pricing architecture of well-defined pricing tiers. In order to maximize deal profitability, the entry price for the smaller deals needed to be lower—and to limit their cost to our company, but the higher-end pricing needed to remain intact and possibly even increase. The larger opportunities were less price sensitive and could support a more value-based, higher margin pricing model.

A smaller deal tier was carved out with a highly competitive entry price—and explicitly limited capability. In this tier, pricing needed to remain firm due to the very thin profit margins inherent in this entry-level, lowest price tier. Two additional tiers were defined to address the medium and larger size deals. Accounts in these tiers were less cost-sensitive but the pricing architecture still had to allow for some pricing flexibility. A "field-owned" pricing allowance was defined to enable a quick, independent response to a competitive bid. Lastly, a custom tier was defined to increase management visibility to the largest deals. This tier would be used for very large, corporate-wide licenses. Management would review the proposals and work with the field to submit a proposal that would ensure landing the deal while maintaining target profitability.

The new pricing architecture was specific enough to allow the publishing of price lists for both the sales team and prospective clients, while flexible enough to customize proposals for large, value-based deals. Ultimately, the belief that a significant number of deals were being lost due to price was unfounded.

SUMMARY TAKEAWAYS:

Never underestimate the importance of field sales input. Client-facing resources are often your best advance warning for pricing problems on the horizon

- Perceived original issues may not always be the problem – you'll need to invest the time to seek the root cause(s).
- Ensure your business practices, pricing architecture, and associated reporting processes are not enabling your customers to commoditize your offers with easy, and sometimes inaccurate, cost comparisons.
- Don't rush to conclusions on pricing decisions. It is only one component of your value proposition. Ideal price-points may vary by industry, segment and deal size.
- Use any pricing adjustments required to move closer to value-based pricing models rather than the more internally focused (and lower margin) cost-plus approach. Use "proxy" value indicators for pricing to avoid commoditization. Customers are often unwilling to divulge the real value they expect to receive for fear of future pricing increases.

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