Pricing Tool Guide

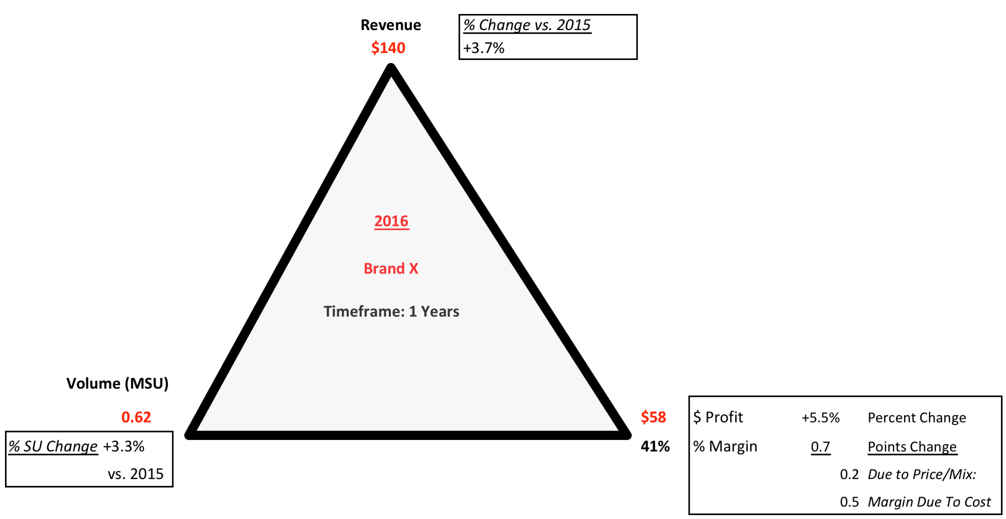
Determining Business Objectives for Price Strategy Development

The achievement of outcome objectives, often called Key Performance Indicators (KPIs), determine the ongoing viability of the enterprise. Those who have invested in an enterprise expect a return on their investment and the KPIs represented in the profit and loss statements are the key measures of success. Unresolved prioritization among KPIs makes it impossible to optimize prices. This **Guide** focuses on how to translate financial objectives into clear direction for pricing. The examples below are from an Excel tool in the ToolKit.

The financial forecast should be the starting point to clarify pricing objectives during a planning period. Whether or not the forecast is still realistic is not as important as its helpfulness in understanding the current promise to shareholders and the priorities implicit in it. To keep things simple at the start, only six numbers are needed – net sales, operating costs, and volume (transactions) for the current and a future year. The choice of the future year is important as the further out years inherently provide more room for strategic choices than years that are closer to the current one.

The Business Triangle below quickly makes visible what the forecast expectations. This provides some initial ideas as price's role in meeting them. The triangle represents the tension that often exists between these objectives when it comes to discussing pricing.

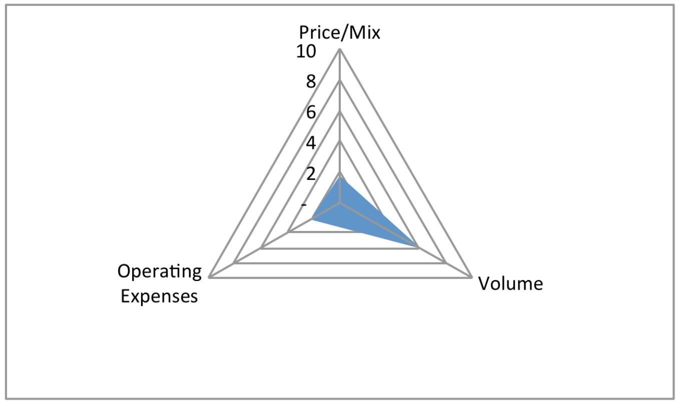
Business Objective Triangle



For an analysis of change in profit perspective, the spider chart below expresses the same financial information to make a compass that points out the relative contributions of volume, price/mix, and operating expenses to absolute profit changes. In this example, volume is key to achieving the forecast, with a modest improvement in price/mix and costs.

Objectives Spider Chart

Business Financial Priorities 2016 vs. 2015

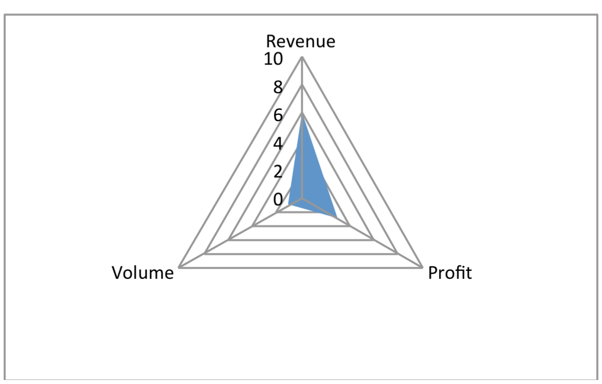


While the financial forecasts are a good starting point for setting price objectives, they are not enough for price setting purposes. Additional chip allocation exercises further identify the relative financial priorities for optimization if deviations versus the forecast are necessary or possible. The spider chart below is the result of a chip allocation exercise that looks at relative optimization priorities for the price changes specifically. In this case, optimizing revenue and profit are more important pricing priorities than volume. Since volume is so important to future profit forecasts, the implication is that non-price measures will drive volume since price is not expected to.

Because there is often confusion about profit in dollar terms or margin terms, a separate chip allocation exercise creates the Harvey ball charts. In this case, dollar profits count more than percent margins. In the long-run, dollars should always matter more, but margin is an important measure of investment potential.

In addition to financial KPIs, market-based KPIs are also often important metrics in objective-setting discussions. The second Harvey ball chart on the right below captures the relative weight of internal metrics vs. external ones such as dollar and SU Share. Again these come from a simple chip allocation exercise to visualize the prioritization. In this case, dollar share is more important than financial results in this time frame.

Pricing Objectives Priorities 2016 vs. 2015



Profit Sub-Priorities	
$ Profit	◕
% Margin	◔

The

Market vs. Business Prioriites

$ Share	◕
SU Share	◔
Internal Results	◔

discussions around the use of these tools contributes to clarity around the prioritization of KPIs – revenue or dollar share, volume or volume share, dollar profit or profit margin – and the outputs provide good visuals to explain those priorities to others. If done right, the following statements should be able to be completed.

1. The business priorities are…
2. Price contribute to achieving these priorities primarily through…

In the case above, the business priorities are revenue and dollar share maximization, driven mostly by volume growth. Price/mix contributes slightly to achieving this goal, but non-price value-driving activities will be the main drivers of volume, with price/mix providing some margin enhancement to reach the profit and revenue goals.