PRICING STRUCTURE SOLUTION

Pricing Strategy

Concept Definition

One of the most important aspects of professional services is the pricing strategy. While determining the appropriate price of the services, products and solutions of the firm is a component of the pricing strategy, there are many critical considerations, including external market factors and internal goals. Firms often struggle to identify the value they create for the client, due to a lack of understanding of the clients' needs or by selling the wrong kind of engagement. When done effectively, creating an effective pricing structure enables the firm to move from selling their time or hours worked to being paid for the value they create. This shift enables professional services firms grow and scale while positioning the firm for a successful exit.

The Problem

The price of professional services offerings is rarely considered a strategic exercise and many times is an afterthought. Firms may place most of their focus on design, delivery, and marketing, and only consider their pricing structure when they are about to launch a new service, or have a new prospective engagement. Too often, firms take a cost-plus approach or apply a competitive pricing methodology due to limited resources or time constraints rather than considering the value generated for client. The lack of focus on the market, client needs, and motivations for buying often result in prices that are too low, too high, or are not aligned with the pricing structure the client desires. Plus, the lack of a strategic approach to pricing, lack of uniformity, and absence of supporting processes can undermine the success of the firm.

SOLUTION TEMPLATE

The pricing of professional services should be a strategic activity that includes thinking through the internal and external factors impacting the firm. Pricing is about market perception, product and service adoption, the value delivered, and willingness for clients to pay for solutions. Pricing is largely about identifying the spot where price and value intersect for clients while making sound financial performance for the firm.

BENEFITS OF THE SOLUTION TEMPLATE

The goal of a pricing strategy is to determine what clients are willing to pay for products, services, and solutions in order to maximize profit, revenue, or market share. Aligning the pricing strategy with the overall strategy and goals of the firm can lead to additional capital for the growth and scale of the firm. In addition, identifying the correct pricing strategy has more influence on profitability than other factors like managing fixed or variable costs.

SOLUTION TEMPLATE - HOW-TO GUIDE

The transition to a strategic pricing approach requires a change in thinking that focuses on value rather than cost. In requires a shift that breaks the cycle of negotiating your costs instead of selling your value. Tightly aligning the pricing strategy with the business strategy is completed by using a 6-step methodology that includes multiple phases and key strategic questions that help identify the right pricing strategy for the firm.

Conducting a complete and comprehensive pricing strategy requires a mix of qualitative feedback and quantitative research to explore the internal and external factors that impact the price of products, services, and solutions. Reinventing the pricing strategy of the firm requires the right people be engaged throughout this process. Identify the key stakeholders and work through this solution guide ensuring buy in as you capture the details and compile the report. Do not make the mistake of completing a pricing strategy without input from internal stakeholders and external clients.

Step One: Segmentation

The objective of segmentation is to focus on the markets where your firm can exercise pricing power. Pricing power refers to the ability to raise your price without negatively impact the demand for your products and services. The more pricing power you have, the easier it is to raise prices. Segmentation is an external analysis to narrow your focus, your efforts and investments in the market and prospective clients so you can better serve them with your solutions, products and services.

PHASE ONE: MARKET SEGMENTATION

- Market segmentation enables firms to target different categories of clients who perceive the value of certain products and services differently from one another. The first phase of market segmentation focuses on aggregating prospective buyers into groups with common needs and who respond similarly to marketing activities.

- The objective is to minimize risk by determining which products and services are most likely to gain share among a target market. Plus, segmentation determines the best way to deliver to the target market and produces the best return on investment.

Conduct an internal review of the competitive landscape of your firm and complete a matrix for reference. Answer the following key questions:

1. **Who are your direct competitors?**
    - The competitive firms that offer virtually identical products or services within the same market
2. **Who are the indirect competitors?**
    - Another company that offers the same products and services as your firm, similar to a direct competitor but the end goals are different.
3. **Who are the replacement competitors?**
    - The firms who offer similar but not the same products or services that could satisfy the client's needs
4. **Identify on what basis the each competitor competes with your firm.**
    - Price competition – lowest price wins
    - Value competition – best product wins
    - Relationship competition – strongest relationships wins

Once you have compiled your competitor matrix and details about the type of competitor, identify how your firm will compete in that market landscape.

For the growth of your firm, what will be the source of that growth?

1. **Taking share from direct competitors?**
2. **Taking share from indirect competitors?**
3. **Taking share from replacement competitors?**
4. **First time buyers?**

PHASE TWO: ACCOUNT SEGMENTATION

The objective of this phase is to prioritize clients that appreciate the value proposition of the firm and are willing to pay for your services. This step allows you to develop a deep understanding of the attributes of a client account that dictates willingness to pay, and the client needs that must be satisfied to command your pricing level.

- This phase of the pricing strategy may require internal analysis, research, surveys, and interviews of your target accounts - including clients, prospects, and outside contacts that may align with your target accounts.

- The key questions to answer in this step are:

    1. Who is your ideal client or account profile?
    2. What does this ideal profile buy today — direct, indirect, replacement, or nothing — and what do they pay for that product or service?
    3. What is the potential spend of the ideal client profile?
    4. What is the willingness to pay for the ideal client profile?
    5. What attributes of an client help determine willingness to pay for the ideal member profile?
    6. What does it cost to acquire the ideal client profile?
    7. What is the lifetime value of the ideal client profile?
    8. How valuable are each of our features or solutions for the ideal client profile?
    9. What is the propensity to buy for the ideal client profile?

PHASE THREE: BUYER PERSONAS

- The objective of this phase is to determine how pricing impacts how buyers or clients make purchase decisions. The ability for professional services firms to sell engagements at the desired price is highly dependent on how well the service offering resonates with the buyers or clients. Buyers have preferences for the solutions, products, and services they buy, the way they buy, and the way they pay for it.

- The primary reason to identify buyers and user personas is targeting to determine price sensitivity. When you target everyone, you are targeting no one. Once you have identified buyers, you will be better equipped to serve client and deliver a superior experience at price the prospect is whiling to pay.

- The key questions to answer in this phase are:

    1. Who is the primary buyer, i.e. detailed persona?
    2. Is the decision to buy made by an individual or a team?
    3. How does the buyer make purchase decisions, i.e. journey map?
    4. What factors do buyers consider before they purchase your products or services?
    5. How relatively important are each of the factors to the purchase decision?
    6. How well does the ideal buyer profile perceive products and services performance on each of the factors relative to the competition?
    7. When a prospective client selects a competitor — direct, indirect, replacement, none —) over your firm, what are the reasons?
    8. What kind of pricing models are your prospects used to?
    9. What do your ideal clients think is the fairest way to set pricing?

- After determining your segments, you want to ensure will be useful for the firm in determining price. A good segmentation analysis should pass the following tests:

    - **Measurable:** Can you calculate an estimate of how much your buyers will spend on your products or services?
    - **Accessible:** Can you identify the best way to reach or meet your buyers?
    - **Substantial:** Have you identified buyers that are interested in your products and services and can be expected to purchase from you?
    - **Actionable:** Have you segmented your buyer persons so there are different and unique from each other?

Step Two: Positioning

The positioning step is an internal analysis of the strategy of the firm. The client acquisition strategy of the firm is reflected in the price positioning. The strategic focus of positioning requires a clearly defined strategy for the firm that aligns with overarching firm goals.

PHASE ONE: BUSINESS OBJECTIVES

- The goal of this phase to match the objectives of the business plan to the pricing strategy. There will be a series of trade-offs to consider and it is important to prioritize the business objectives the pricing strategy will facilitate for the products, services and solutions of the firm.
- The key questions to answer are:
    1. What are the business objectives of the firm?
    2. What is the business strategy(product differentiation, price leadership, or service)?
    3. What is the strategy of the product or service?
        - Penetrate new market?
        - Increase average revenue?
        - Premium provider in the market?
        - Value/low cost provider in the market?
        - Exclusivity/luxury provider in market?
    4. Does the current pricing strategy align with the products and services strategy?

PHASE TWO: COMPETITIVE PRICE POSITIONING

- The objective of Phase 2 of Pricing Strategy is to understand and influence perception. What clients perceive regarding your value proposition and your performance compared to the competition will dictate if you win - and at what price. The business plan of the firm depends heavily on the ability to influence these perceptions with potential clients.

- The key questions to answer in this phase are:
    - When comparing your direct, indirect, replacement and "do nothing" competitors, on what product, services or solution attributes do they evaluate your firm when making a decision?
    - How relatively important are each of these attributes?
    - How does your firm perform on these attributes relative to the competition?
    - How well do prospective clients perceive you perform on each of the attributes relative to the competitors?

- Which of your product, service or solution attributes are competitive advantages, i.e. attributes that are very important to prospect and you are perceived to be better than the competitors?
- Which of your attributed are competitive disadvantages, i.e. attributes that are very important to prospects, but you are perceived as worse than competitors?
- Which attributes are overinvestments or attributes that are perceived to be better than competitors but not important factors to prospective clients?
- What are the gaps in perception for your firm and how can you close those gaps?

Step Three: Structure

The objective of the third step in the process is to select a revenue model that will satisfy the needs of clients and will meet the objectives of the business plan of the firm. More than any other part of pricing, the revenue model is the way to communicate to the prospective clients exactly what products, services, or solutions they are purchasing. What clients are purchasing should align to the way they receive value from the firm to help determine the correct plan.

PHASE ONE: REVENUE MODEL

- No revenue model is universally better than another as it depends on the unique situation of the firm. Seek alignment and do not to choose a revenue model that is out of alignment with the client value as it will negatively impact client acquisition. Selecting the correct revenue model could solidify your firm as an industry disrupter.

  1. Which of these revenue models align best with client value and the business plan objectives?
     - Time & Materials
     - Fixed Fee
     - Deliverable
     - Productized Services
     - Subscription or Retainer
     - Market Pricing
     - Gain Sharing
     - Managed Services
     - Knowledge as a Service
     - Software as a Service
     - Value Networks

2. Which of the above revenue models do the competitors use?
3. How do your clients "consume" the product, services, and solutions?
    - Use once
    - Use infrequently
    - Use regularly
    - Use daily
4. What kind of budget do clients use to pay for the engagements - whether CapEx or OpEx, and how flexible is it?
5. Do clients prefer to pay in one lump sum, recurring payment, by phase or per transaction?
6. Would clients be willing to pay a lump sum up front to lower subsequent payments?
7. Would client by willing to pay an annual fee in order to lower a transaction fee?
8. What is the prospective clients' tolerance for unpredictable costs?
9. Would clients prefer to pay a fixed or variable fee depending on the value received in a defined time period?
10. To what extent would the items above affect the business plan of the firm?
11. To what extent does the current revenue model match the preferences of the prospective clients?
12. To what extent is the revenue model "disruptive"?

PHASE TWO: VERSIONING

- The objective of this phase is to design product or service versions that allow prospective clients to choose their price point and buy faster. Choices are an integral part of effective pricing strategies and help the prospective client understand the link between price and value to facilitate decision making.
- The key questions to answer in this phase are:
    1. How sophisticated is the client when deciding to purchase your products, services, or solutions?
    2. Would different pricing models be beneficial for addressing the different levels of sophistication? If so, how many versions at different price points?
    3. What features, solutions, or attributes should the versions be based upon?
    4. Is it possible to create a versioning structure that clearly demonstrates the relationship between price and value?
    5. If different versions are offered, can the versions be easily explained? For example, can the differences be easily be explained as version 1 is one is for clients who want X while version 2 is for clients who want Y.

PHASE THREE: PRICING METRICS AND FENCES

- The objective of this phase is to choose an appropriate metrics, or fences, to scale pricing to for those clients with different willingness to pay. Prospective clients with a lower willingness to pay may not be willing to settle of a lower value option as small clients may have same needs as larger clients. This may require a change to your pricing structure with the implication of losing profitable low-end business and under monetizing larger accounts.
- Price metrics and fences are the solution to this if prospective clients agree with the justification and logic. Key questions to answer in this phase are:

1. Which price metric do you currently use?
2. What kind of price metric are you using?
    - Direct: Measure something about the prospective client to set the price
    - Indirect: The prospective client selects the scope or volume they want to purchase
3. Do you openly communicate to the prospective client that this metric is used?
4. To what extent does the price metric align with the value delivered to the client?
5. To what extent does the price metric align with willingness to pay?
6. Does the prospective client perceive the price metric to be fair?
7. Is the price metric common in the industry or niche?
8. Is the price metric easy for teams to communicate with prospective clients?
9. Is the price metric verifiable with ability to measure directly and without relying upon the prospective clients estimates?
10. Is the price metric intractable so the prospective client cannot manipulate it?
11. Does the price scale linearly with the price metric or as a step function?
12. Should you use price fences to change price to prospective clients without changing product, service, or solution offering or scope?
13. Is it clear which fence should be targeted for prospective clients?

14. Is the price fence based on?
    - Industry
    - Geography
    - Company size
    - Loyalty
15. Is it transparent to prospective clients that you use fences?
16. Does the value received by clients change across price fences?
17. Does the willingness to pay change across fences?
18. Do the prospective and existing clients see the fence as fair?
19. Is the fence common in the industry?
20. Is the fence easy for sales and marketing to communicate?

PHASE FOUR: PACKAGING

- The objective of phase 4 is to raise the average sales price by using an appropriate packaging strategy which ideally allows you to charge more while doing less. This may include packaging reusable intellectual property to increase differentiation of the firm or converting that IP into a reoccurring revenue stream that increases value. An important element of a pricing strategy for professional services firms is how IP is packaged, valued and factored into the pricing equation.
- The key questions to answer in this phase are:
    1. Do prospects prefer simplicity and are they willing to live with little flexibility?
    2. Do prospects prefer flexibility and are willing to live with complexity?
    3. Which packaging approach would please prospect most:
        - All included — one choice everything included
        - Needs based — bundles tailored to needs to prospect
        - Good/better/best — gradation in quality or quantity
        - Flexible bundling — prospect makes discrete choices and creates their own bundle
        - A la carte — prospect makes granular choices across a range of components

4. Should you use the same system for prospective clients and existing clients?
5. What type of packaging do your competitors use?
6. How should you choose:
    - Adopt industry standard
    - Based on prospect preference
    - Adopt approach of closet competitor
    - Aligned to flexibility/complexity tolerance of prospective new clients
    - Aligned to business plan objectives
7. How should you incentivize purchasing in packages?
    - Price - cheaper prices for packaged purchases
    - Value - integrated components so packaged purchase provides extra value

PHASE FIVE: CONTINUING MONETIZATION

- The objective of this phase is to grow client revenue over time. This is a critical component of growing and scaling professional services firms or the focus will remain on new client development.
- The key questions to answer in this phase are:
    1. Do you have a strategy to grow revenue from existing clients?
    2. Is it based on:
        - Price increases for the same product
        - Product upgrades and add-ons
        - Cross sell other products
        - Adjustments for inflation
    3. Does your product roadmap include price adjustments?
    4. How should these be communicated to current clients?

Step Four: Price Levels

The objective of the fourth step in the process is to determine the viable price range and optimized price for prospect clients based on willingness to pay. The optimal price is the price at which your firm can make the most profit for products and services.

PHASE ONE: PRICE LEVEL OPTIMIZATION

The key questions to answer in this phase are:

1. Which methodology should be used by your firm to set price:
    - Cost Oriented such as Cost-Plus, Markup Pricing, Target Return
    - Market Oriented such as Perceived Value, Value Pricing, Competitive Rate, Risk based, or Differential Pricing
2. At what price point do prospective clients feel they are getting a good deal?
3. At what price point do prospective clients begin to consider your offering to be expensive but still worth considering?
4. At what price point do prospective clients consider your offering too expensive to even consider?
5. At what price point do prospective clients consider your offering so cheap that they begin to question the value of the product, service, or solutions?
6. What are the variable costs of adding a prospective client?
7. What is the revenue maximizing price point for your firm where total revenue is maximized?
8. What is the profit maximizing price point for your firm where profit would be maximized?
9. What is the penetration maximizing price point for your firm where market penetration would be maximized?
10. Do your prices currently reflect and overcome the key psychological thresholds at which a significant portion of the population will no longer buy your products, services, and solutions?

PHASE TWO: STRUCTURED DISCOUNTING

- The objective of this phase is to consider a discount strategy to increase sales volume and average deal size for your business. Discounting without a rationale or knowledge of the impact has negative consequences and teaches clients to buy incorrectly. However, deciding in which situations you are willing to give a discount, modify scope, adjust deliverables, and importantly, what you expect to get in return for the discount.
- Key questions to answer in this stage are:
    1. Do prospective clients expect a discount?
    2. If they do expect a discount, what are there stated reasons:
        - Competitor offered a lower price
        - Client is offering to do a large deal or multiple project phases
        - Prospective client is willing to commit to multiple years
        - Client is willing to provide referrals or a testimonial
    3. If you agree to provide a discount based on the above what is the percentage off?

Step Five: Price Execution

Implementing your pricing strategy includes more than identifying not only how the prices is calculated or charged. Executing the pricing strategy includes how price and value creation is identified in marketing materials and proposals as well as determining the KPIs that will be tracked due to the updated pricing strategy.

PHASE ONE: VALUE MESSAGING

- The objective of this phase is to drive up the prospective clients willingness to pay with compelling messaging the reinforces the value proposition of the firm. While you may know that your products, services, and solutions are better than the competition, you prospective clients do not. To achieve a premium price in the marketplace, it is necessary to reinforce the positioning through value messaging in all points of communication with clients.

- The key questions to answer in this phase:

    1. Do you know the points of differentiation between your firms and the alternatives?

    2. Have you produced messaging to reinforce your competitive advantage?

3. Do prospective clients expect a discount?
4. Have you produced messaging that downplays your competitive disadvantages?
5. Have you produced messaging to raise the importance of your over investments?
6. Have you translated the above into marketing materials, contracts, talking points, and key messaging for sales members and client facing teams?
7. Can you quantify the value that your products, services, and solutions delivers for your clients?
8. Are your sales team able to do a value calculation for with prospective clients during the sales process?
9. Have you enabled your sales force to perform a value calculation through a "value calculator" tool?

PHASE TWO: NEGOTIATION GUIDELINES

- The objective of this phase is to enable your sales team to win deals at maximum price. Some prospective clients will buy on price alone while value buyers will pay more for more value. The challenge is that some value buyers may try to convince your team they are price buyers to achieve a lower the price.
- Classifying prospective clients into price buyers and value buyers and knowing when and how much discretionary discount to allow can make the difference between slow and fast growth.
- Key questions to answer in this stage are:
    1. What portion of prospective clients are price buyers?
    2. What portion of prospective clients are value buyers?
    3. What portion of prospective clients are relationship buyers or willing to pay a premium to do business with a firm in which they enjoy a strong relationship?
    4. What portion of the prospects are negotiators and will try to convince your firm that they are price buyers?
    5. Does everyone in your firm understand the cost structure and at what point a deal becomes unprofitable?
    6. For your firm and the products and service offerings, what distinguishes a price buyer, value buyer, relationship buyer, and a negotiator?
    7. Have you trained your team on how to recognize the different buyer types based upon the classification and how to uniquely handle each buyer?

PHASE THREE: PRICING KEY PERFORMANCE INDICATORS

- The objective of this stage is to track the right metrics to ensure the pricing strategy of the firm is successful. With the time investment and importance of the pricing strategy for the financial health of the firm, it is necessary to ensure it is working. Price strategies touch all parts of the business and both positive and negative impacts can hidden in the results. The new pricing strategy should be launched with clarity on KPI's that will show points of success and failure, and how you will calculate and baseline these metrics.
- The key questions to answer in this phase are:
    1. Which pricing metrics will help you measure the effectiveness of the pricing strategy? Consider the following and adjust according to your business.
        - Average deal size
        - Average discount rate
        - Average margin $
        - Average margin %
        - Win rate or close rate
        - Client retention rate
    2. How frequently should these metrics be calculated?
    3. Based upon your firm, should these metrics be segmented in some way?
        - Submarket industry code
        - Firm size
        - Geography
        - Lead source
    4. Who is responsible for tracking this?
    5. How will the results be displayed and distributed to key stakeholders?
    6. How will these metrics be used over time to improve the pricing strategy?

Step Six: Price Infrastructure

The objective of this step in the process is to consider how the pricing strategy will be executed and how software or systems can help execute the pricing strategy. This includes assessing the organizational readiness of existing tools in support of the new pricing strategy, the need for pricing optimization software, and the quantified benefit of the software.

PHASE ONE: TOOLS, SYSTEMS AND SOFTWARE

- The key questions to answer in this phase:

    1. What tools, systems and software should be use for calculating prices and tracking the pricing strategy?
    2. Should visualization or specialize analytics tools be used?
    3. Is a price management or optimization software needed?

SOLUTION SUMMARY

One of the most important aspects of professional services is the Pricing Strategy. While determining the appropriate price of the products, services, and solutions of the firm is a component of the pricing strategy, it is much more strategic activity based upon external market factors and internal goals. When done effectively, it enables the firm to move from selling their time or hours worked to being paid for the value they create. Aligning the pricing strategy with the overall strategy and goals of the firm can lead to additional capital for the growth and scale of the firm.