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RIEKHOF ON PRICING No 39

Is Centralization
the Way Forward in Pricing?

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Those who work close to and together with customers (hopefully) know best what customers need, how fierce the competition is and how much people are willing to pay. So it may come as something of a surprise that in this newsletter I want to share some thoughts with you on the topic of centralized pricing. That's what this newsletter is about.

Discussions with the directors of medium-sized companies have prompted me to address this issue.

A Bold Assumption: "Our Experts on the Ground Know the Market and the Customers Best"

Many entrepreneurs may consider the question "Is centralization the way forward in pricing?" to be rather provocative. It is, after all, common practice in many companies to grant sales offices, branches or subsidiaries a high or even very high degree of autonomy when it comes to pricing. At the end of the day, it's the experts on the ground who can best assess the customer, the local market and the competition. But today we will examine whether largely decentralized pricing is the only alternative.

How can companies with highly complex product ranges comprising, say, 20,000 or more individual products effectively map the differences in (perceived or indeed measured) price sensitivity? In our pricing projects, we work with a category model that I would like to present in this newsletter.



POISSON DU JOUR	
SEICHE	12 €
MOSTELLE	28 €
S ^t . PIERRE	28 €
LOTTE	28 €
ROUGET	28 €
DAURADE	25 €
CHAPON	28 €
RASCASSE	15 €
PAGEOT	22 €
SOUPE	14 €
LANGOUSTE	70 €
LOUP/BAR	25 €
MERLAN	15 €

"Our branch managers and sales heads in our subsidiaries know the local market best. That's why we don't interfere with their local pricing strategies."

"You should be extremely cautious when you hear statements like this. It could be a sign that the pricing processes are yesterday's news."

Prof. Dr. Hans-Christian Riekhof



What are the Arguments in Favor of Decentralized Pricing?

First of all, there is no question that knowledge of the market at a local level is always better than that at the more, or less removed corporate headquarters, at least in terms of the specifics. However, whether a branch office close to the border with one of our European neighbors has a completely unbiased view of the entire market is another matter.

But what hopefully works well is combining regional insights to arrive at a conclusive overall picture. How to involve your sales force in pricing research in a methodically reliable way will, incidentally, be the subject of a subsequent newsletter.

Decentralized Pricing at McDonald's

One of my seminar participants, an entrepreneur and franchisee, was responsible for several branches of McDonald's. He gave us an insight into the decentralized freedom of local entrepreneurs to set prices: ultimately – within the limits of their own calculations – responsibility for pricing lies entirely with the franchisee, something the general public may not be aware of. So, a Big Mac does not necessarily cost the same in all parts of Berlin. One particular challenge for every franchisee is the need to quickly adapt to changing customer wishes and to different target groups in the restaurant at different times of the day. Interestingly, all international transaction data is then evaluated centrally at the corporate headquarters of McDonald's in the US.

“There is no question that knowledge of the market at a local level is always better than that at the more, or less removed corporate headquarters. ”

Prof. Dr. Hans-Christian Riekhof

Decentralized Pricing in International Corporate Groups: Buying a Private Car

Do you remember the last time you bought a new car? An almost ritualistic part of the process is the personal discount you manage to negotiate on the list price. Then later, proudly announcing to your drinking buddies that you got the dealer to knock another 13% off the list price. Responsibility for pricing lies with the decentralized local car dealer, who also has the option of offering more, or less attractive deals on the end-of-life vehicle you are trading in.

However, this is by no means to say that pricing in the automotive industry is completely decentralized. In fact, the VW Group, for example, has a strategic group pricing function that very strictly ensures that the price differentials between the comparable models of Skoda, VW, Audi and Porsche are adhered to.

Centrally Managed “Decentralized Pricing”: The Market for Delivery Vans and Transporters

As part of one of our pricing projects, we also had to grapple with the pricing systems for transport vehicles such as those offered by Volkswagen, Mercedes and almost all other major manufacturers and used by delivery services, as well as by tradespeople. This gave us an opportunity to experience first hand the conflicting interests between the sometimes very short-term actionist terms managed centrally via the system and the efforts of the decentralized sales organizations to complete sales in order to achieve quarterly targets. The complexity threatened pricing efficiency to a significant extent.





What are the Disadvantages of Largely Decentralized Pricing?

There are empirical studies showing that, especially in B2B business, granting the sales team a high degree of autonomy has a detrimental effect on pricing efficiency. This is not surprising given that in most organizations the sales team is driven by revenue and market share targets.

Furthermore, a sales employee will always tend to estimate the risk of losing a customer over price as rather high, especially since they are well aware of the high cost of acquiring a new customer. This means that many sales organizations have only a limited incentive to prioritize enforcing higher prices or consistently adhering to the pricing strategy. Following this rationale, defending revenue and market share by means of moderate pricing is a thoroughly rational strategy.

“To capitalize on how much people are willing to pay in different regions or countries, an international pricing strategy is required for each product area.”

Prof. Dr. Hans-Christian Riekhof

Centralization of Pricing

Centralization of Pricing: The Tasks of Product Management

In a number of pricing projects, we redefined the distribution of tasks between (product) marketing respectively product management and sales: product management is responsible for the strategic focus of pricing and the positioning of the product program. This should always include statements about the value drivers of the products and the core statements of a customer benefit argumentation. The respective requirements of the markets and market segments must be bundled and prioritized, because as a rule it is not possible to serve every niche and every customer.

Centralization of Pricing: Discount Structures and Discount Guidelines

In these projects, product management was also assigned the task of creating binding strategic guidelines for (international) discount structures. This includes answering the question of what margin of discretion is available to the sales department (which it by no means has to exhaust) for granting discounts to which customer groups, distribution partners or sectors.

Centralization of Pricing: Big Deal Pricing

One of the most important reasons why the debate about centralized or decentralized pricing is being conducted at all is because of international customers who either demand uniform selling prices for all their subsidiaries in the various countries, or who, by dint of their respective negotiating clout, simply want to transfer the lowest price in one country to an entire region (for example, Europe).

Country managers are quickly out of their depth here because they tend to fight their own corner against the interests of the overall market, making international coordination necessary. We speak in this context of the



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big deal pricing process, which requires centralized management and responsibility. Accountabilities must be defined for the list of (international) key accounts, and we usually also recommend creating a centralized big deal database in which the agreed terms and conditions and their validity are documented.

Centralization of Pricing without Standard Prices

This should by no means be taken to infer that this process involves establishing a standard price for the entire region. After all, different warehousing and transport costs, logistics and wage structures, service levels, call-off regulations and lot sizes, or even IT integration lead to different expenses, which also justify differentiated prices. So, although in most cases a (European) standard price is still a long way off, an underlying uniform price logic is generally the rule.

Centralization of Pricing: Pricing Research



Based on our RSEC model of pricing, pricing starts with a (hypothesis-driven) compilation of customer and market information on pricing and value drivers in the respective market segment. In this context, it is advisable to prepare pricing information in the respective markets using a uniform methodology and system. This also requires centralized responsibility for pricing research (which, in our experience, exists in very few companies).

Centralization of Pricing: International Pricing Strategies



To meet the expectations of some customers for standardized conditions and at the same time capitalize on how much people are willing to pay in different regions or countries, an international pricing strategy is required for each product area. The executive board should require product management to present this pricing strategy.

Centralization of Pricing: Uniform Implementation Concepts



Management of (international) pricing becomes much easier if the appropriate levers and tools for strategy implementation are available. This includes standardized pricing processes, IT systems for pricing, incentive systems and communication tools.

Centralization of Pricing: (International) Price Controlling



What is the task of centralized price controlling? Ultimately, the aim is to create company-wide transparency as to which branches or subsidiaries are implementing the international pricing strategy most effectively. Of course, this is only possible if the

individual price components (gross and net prices, rebates, discounts, advertising expenses, etc.) are uniformly defined and uniformly integrated into the IT systems. This type of price controlling has not yet really taken hold in all companies, but it seems to me that establishing this transparency is essential in order to implement a pricing strategy.

Centralization of Pricing: Learning from MediaSaturn



Florian Welz, who at the time was responsible for pricing at MediaSaturn, gave me a fascinating insight into the **planned centralization of pricing at MediaSaturn in an interview** on this very topic. Here is a brief summary of the key points:

- In the future, pricing for the entire European market will be managed from Ingolstadt and will be independent of product management/category management.
- A data warehouse is to be created for this purpose, which will calculate prices on the basis of corresponding algorithms.
- The calculation takes many factors into account, including the intensity of local and national competition and online prices for the products on offer.
- The prices (at least for stores with the corresponding technical means) are transmitted to the stores from Ingolstadt via ESL (electronic shelf labeling). Multiple price changes during the course of the day should be avoided, because this would likely meet with customer reactance.

This strikes me as being a very ambitious project. We will see what obstacles are encountered during execution.

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