Whitespace Consulting Group Case Study
CLOUD COMPUTING – Pricing Strategy and Architecture

> *"Good innovators typically think very big and they think very small. New ideas are sometimes found in the most granular details of a problem where few others bother to look. And they are sometimes found when you are doing your most abstract and philosophical thinking, considering why the world is the way it is and whether there might be an alternative to the dominant paradigm. Rarely can they be found in the temperate latitudes between these two spaces, where we spend 99 percent of our lives."*
>
> -- ***Nate Silver,* The Signal and the Noise:**

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.

Client Background

The client is a $40M cloud computing software company that provides a document-sharing service via the Internet. The client's primary business provided virtual data and deal rooms, where companies can perform online due diligence. The services offered provided an alternative to physical "brick and mortar" deal rooms. The due diligence materials are used to determine the value of merger and acquisition candidates. The client also provides 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"

The client's sales organization felt the company's products and services were not priced competitively, resulting in an unacceptable loss of sales. A recent stream of losses to a primary competitor bolstered their claim. Sales leadership requested that the Chief Marketing Officer (CMO) examine the corporate pricing methodology to determine if it was in-line with industry practices. The Whitespace Consulting Group was retained by the CMO to analyze their current pricing strategy and to determine its effectiveness.

Management Concerns Identified

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 and 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.
- Marketing was seeing less "uptake" by new customers and loss of user-fees, causing a reduction in budget for marketing activities supporting new customer acquisition.
- The uncertainty of meeting quarterly financial commitments negatively impacted the client's financial credibility, limiting their ability to attract new investors for additional rounds of funding.

Interviews Uncover Additional Pricing 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 any "viral" adoption more difficult.
- Additionally, our client's 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 non-standard pricing terms.
- Most of all, our client's management team wanted their products and services pricing to be simple and easy to understand. They wanted their services to be easier to buy than competitive offers.

Digging for the Root Cause of Lost Sales

With buy-in from client management, 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, we 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 client's solution set, sales relationship and overall brand carried a premium. The difference in outcome was based on deal size and complexity. The majority of deals lost were smaller in size and complexity. This suggested greater cost sensitivity on the smaller, lower cost deals. In addition, we discovered that our client would have realized a net loss if they had lowered their pricing on the largest deals in order to win. Any new pricing architecture had to take into account the varied implementation costs associated with each deal.

We also discovered that our client's detailed, bi-monthly client usage reporting was enabling, and even encouraging, customers to perform internal and external cost comparison, further *commoditizing* their offers. 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 our client. These requests undermined the relationship and applied unwanted pricing and margin pressure on both current contracts and future proposals.

WCG's 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, 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. In this tier, pricing needed to remain set 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 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 very 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 with maximum 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.

Mike Peters is the managing director of the Whitespace Consulting Group, a global business development strategy firm. The Whitespace Consulting Group has been helping multi-cultural clients optimize their business development strategy since 2005. He can be reached at mpeters@whitespace-consulting.com, @WhitespaceCG,