

# The Age of Price Segmentation Has Arrived

*Advances in pricing technology is making the application of foundational pricing theories, such as value based pricing and price segmentation, more accessible and profitable for companies in multiple industries. In this article, the author explores the history of price segmentation and explains how technology is enabling the utilization of advanced segmentation, even in companies with commodity products or products with multiple price points. Author Adam Corsi has been involved in pricing for more than twelve years and is currently a Business Consultant with Vendavo. He can be reached at [acorsi@vendavo.com](mailto:acorsi@vendavo.com).*

In 1738 a Dutch-Swiss Mathematician name Bernoulli developed the formulas that helped define fluid mechanics and ultimately prove that air flight was possible. But it took another 165 years for the technology to evolve to the point of practicality, not to mention the hard work of the Wright Brothers to make it a reality. In a similar sense, the theory behind concepts such as value based pricing and advanced pricing segmentation have also been around for the past few decades, but with very few practical examples. But just as smaller and lighter internal combustion engines (not to mention good wing design) made flight possible – more robust pricing technology solutions are enabling the advanced segmentation through better administration and execution of pricing actions. This article serves to walk readers through the historic evolution of pricing segmentation and discuss

how emerging technologies are now enabling breakthroughs in this field in actual practice.

## The Theory

The pricing segmentation world began with the theory defined several decades ago by many leading pricing experts, including consulting firms such as McKinsey & Co. Shown below in Figure 1, the reasoning for advanced segmentation – or really pricing differentiation, began on the premise that you could gain higher prices for some customers. As differentiation increases, the concave pricing value curve (labeled “P” and depicted in green) flattens as you eventually asymptote into a finite amount of customers.

Correspondingly, costs are incurred in administering this pricing differentiation, and eventually the convex cost curve (labeled “C” and depicted in red) overtakes the value created through differentiation if pricing variety becomes too complex. When you layer the two curves together to calculate the value (Price – Cost) you establish Figure 2 - The optimal theoretical curve.

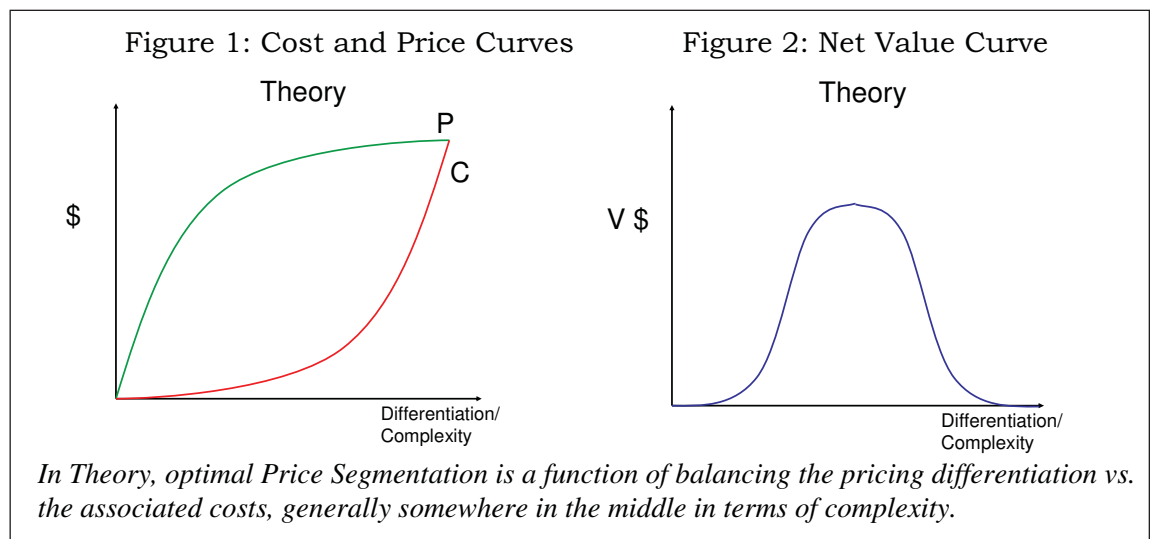
**Based on this theoretical curve, the recommendation is to balance the price differentiation vs. the administrative costs associated with managing the price complexity – normally somewhere**

**in the middle along the value bellcurve.**

## The Reality

Unfortunately, the reality of pricing differentiation has diverged from the theory when applied in practice. Companies that have pursued this course of price differentiation have generally experienced price, cost and value curves more in line with Figures 3 & 4. **In the real world, price capture via differentiation is very difficult beyond the most rudimentary segmentation strategies (i.e., Regional or Channel Pricing) as it becomes more challenging to manage and administer this exponentially increasing level of complexity through the gauntlet of pricing administration and execution at the Customer (Sales) level.**

With increasing levels of complexity, the strategy often gets lost in execution and ends up as “price differentiation for differentiations sake” as Sales takes the opportunity of price variation to set the price at levels that prevent them from losing any deals, regardless of immediate profit impact or long term effects – hence a quickly flattening price curve. In some cases, lack of controls can actually enable Sales to indiscriminately apply price differentiation, which can quickly lead to pricing chaos and a price curve that actually decreases. On the other side, the cost curve in reality is much steeper as legacy systems were de-



signed to meet the requirements of much simpler environments (think List Price with multipliers). As organizations have layered Excel spreadsheets upon spreadsheets to try to manage this complexity, it creates resource costs in both headcount & inefficiencies – not to mention invoice inaccuracies.

Unfortunately, combining these two curves explains why most companies today have not been successful with advanced pricing segmentation or value based pricing. Figure 4 demonstrates why most companies have retreated from more complex segmentation strategies, ultimately settling on only the most basic strategies. **The harsh reality up until this point is that the technical infrastructure to implement advanced segmentation strategies through both pricing administration and sales execution has simply not existed.**

## The Future is Here Today

Just as Orville and Wilbur's practical and scientific approach eventually enabled the transformation from Bernoulli's theory to reality, technical developments in enterprise pricing solutions have not only enabled the reality of advanced pricing segmentation, but have actually increased the potential opportunity.

First, as Figure 5 demonstrates, pricing is enabled to mirror the theoretic curve by addressing two of the greatest barriers – administration and execution of differentiated pricing. Recent advancements in enterprise pricing solutions enable stronger setting and management of target prices and thresholds throughout administration and execution of prices for detailed segments – ultimately clos-

ing the communication gap from strategy through technical administration to the Sales organization. **As clear pricing targets can now be communicated to Sales as they are creating customer pricing, they have greater visibility and awareness of pricing expectations as well as approval thresholds based on their pricing relative to these targets.** As Sales begins grasping these concepts and begins being evaluated in their performance relative to their pricing targets, you immediately see the integration and power associated with segmentation and value based pricing.

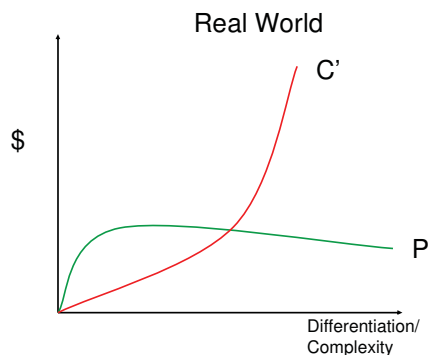
Second, as enterprise pricing solutions eliminate the need for cumbersome processes and disconnected spreadsheets, the cost curve (Labeled C'' in Fig 5) essentially becomes flat based on the fixed

cost of the enabling technology. Combining these yields the value curve in Figure 6, demonstrates that not only is advanced pricing segmentation and value based pricing now fully enabled, but actually exceeds the theoretical value of a bell curve as costs have been reduced.

## Conclusion

The evolution highlighted in this article is why cutting edge companies are now able to manage thousands of price points for one product – enabling greater profitability capture than ever before. And even companies with products that many consider commodities, such as chemical companies, are now able to establish differentiated price segmentation strategies across a wide dimension of attributes and maximize profits.

Figure 3: Adjusted Curves



*In Reality, costs tend to ramp up faster with increased pricing complexity and lack of integration through administration and execution lead to less value capture through differentiation.*

Figure 4: Adjusted Net Value Curve

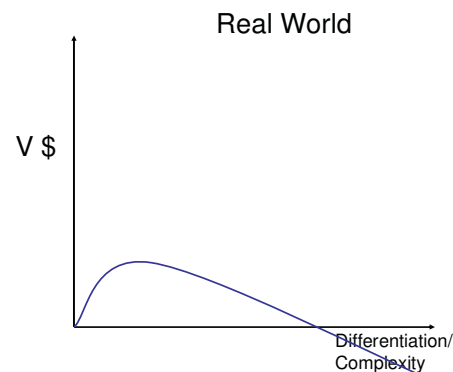
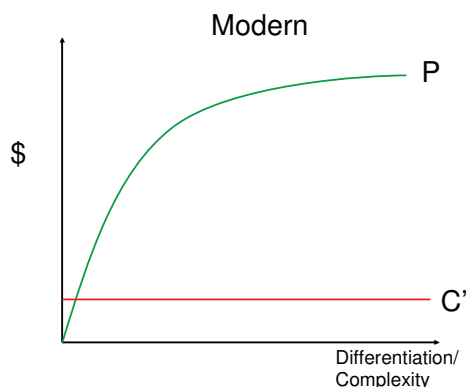


Figure 5: Current Curves



*Enterprise pricing systems now enable a fixed cost structure to administer and execute increased Pricing segmentation models - thus transforming the value curve to even greater levels.*

Figure 6: Current Net Value Curve

