



Price Management: Three Insights for the Chemical Industry

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Spending on price management projects in the chemical industry will increase overall by 10% in 2008, with 33% of companies planning to increase spending. But since asset-intensive industries like chemical have long been leaders in price management, many would ask, "Why the planned increase in 2008?" The answer is simple: The value proposition is great.

Consider what AMR Research discovered through our recent quantitative study of 28 chemical companies that have deployed price management technologies. For starters, 92% of chemical companies report improved profitability from the investment, while 54% have improved the recovery of supply-side costs for customer special requests, according to our study. There's no doubt that the primary driver for increased spending on price management is profitability.

Additionally, the average payback for the investment is 11 months, with a median value of 9 months. This payback beats most other industry subsegment averages.

46% of companies surveyed have also improved price compliance in sales and contract management, and 31% have been better able to improve concession control in deal management. All of these are important factors in combating rising inflation.

Current state of the market

Price management is the end-to-end process requiring the synchronization of the optimization, execution, and enforcement of price. It includes three separate and distinct processes that leaders define and align for success. Less successful companies, however, allow elements to exist in isolation.

The chemical industry is at different places in the automation of the following processes:

- **Price optimization**—This is the process through which prices are determined. 61% of chemical companies utilize price optimization technologies, according to our study.
- **Price execution**—This is where prices are delivered and communicated to salespeople and buyers. 32% of chemical companies had integrated price into contract management systems, with the majority of companies relying on spreadsheets and e-mail for pricing communication.
- **Price enforcement**—This includes the processes and tools that support deal negotiation and contract compliance. Historically a strong area for chemical companies, 64% of companies in our survey have implemented strong price enforcement systems.

There are two main barriers in the industry for driving wider adoption and greater improvements through price management: limited resources and alignment of cross-functional objectives. The cross-functional alignment of commercial teams with supply-side operations is a consistent cross-industry theme for companies trying to build effective demand-driven value networks.

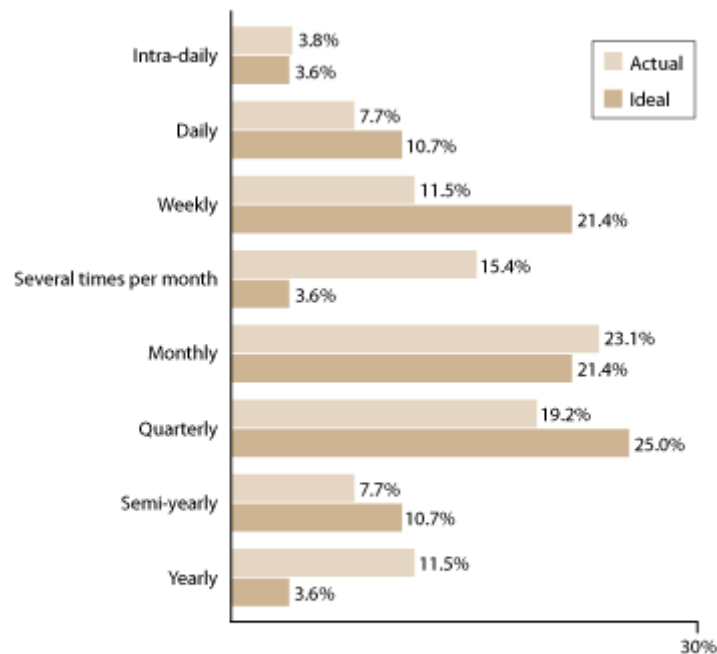
Market insights

Consider the following three insights gained from our study:

No. 1—Market frequency for analysis is increasing

With the current volatility of market price, chemical company leaders would like to increase the frequency of price optimization and price execution. For companies still reliant on spreadsheets and e-mail, though, this will be a challenge.

Figure 1: Price optimization—actual versus ideal frequency



Companies currently using pricing management = 26

Q: How frequently does your organization assess and optimize its prices today? In your opinion, what would be the ideal frequency for your organization to assess and optimize its prices?

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Source: AMR Research, 2008

It's imperative that companies considering price management projects think holistically about the effects of price optimization, execution, and enforcement with this pending change to the frequency of price management modifications. We find the most successful projects are those that focus on a company-wide redefinition of the process, not just for a subsegment in isolation.

No. 2—Lost margin opportunities are everywhere

67% of the companies we surveyed said they were currently engaging in price management activities, but only 20% actively model both demand elasticity (market potential) and supply-side capabilities (margin sensitivity to volume) to maximize profitability in pricing decisions. With the strong tie between the balance sheet and asset returns, connecting these dots is a large opportunity for most chemical companies.

For supply-side analysis and profitability alignment between demand and supply to maximize margin, best-in-class companies use sales and operations planning (S&OP). However, we find that less than 5% of companies are successful at evaluating these tradeoffs. This is especially acute in multistep, vertically integrated processes, where each business operates as a profit center.

For supply-side capabilities, **Maxager**, **pVelocity**, or **SignalDemand** should be on the short list for consideration and close examination.

No. 3—The current focus is on cost to deliver, not cost to serve

For the average chemical company, about 33% of revenue gained required the inclusion of special price requests and customer exceptions. The two major drivers for both are fluctuating market conditions and pressure to match competitor pricing. While 59% of companies consider customer contribution margin in this analysis, only 39% evaluate and manage the cost to serve. As a result, the true cost impact of special requests goes largely untracked.

For help in understanding the cost to serve, consider new products from **Acorn Solutions**, **SAS**, and **SAP**. As the market shifts into one that's more supply side—where sellers have more power—chemical companies will then have the ability to charge extra for special considerations.

We look forward to your ideas and feedback—Iccere@amrresearch.com and bpolk@amrresearch.com.

Related research

For additional reading on topics related to price management in the chemical industry, see the following:

- "AMR Research's Price Management Model"

- "Price Management Needs To Become Standard Practice"
- "Building a Bulletproof Business Case for Pricing Improvement Initiatives"
- "What Is Demand Shaping?"

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