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Feature Article

More Science, Less Art: Service Parts Pricing Technology Uncovers Untapped Revenue Opportunities

Mike Landry, CTO & Founder, Servigistics



A few weeks ago, my wife and I decided to tackle that nefarious task of cleaning out the basement for a garage sale. We carted years of transistor radios, televisions, mismatched drinking cups, baby cribs, dining room chairs, and motorcycle parts up the stairs and onto tables set up in the front yard. Then began the art of assigning prices to our once-beloved items.

"Honey, how much for this?" My wife asked as she held up a stainless steel boat propeller that I'd purchased years ago for my boat.

How much indeed. I bought that propeller for over \$500 dollars and never even used it. What is it worth now?

"Oh, just list it for \$50 bucks," I said. Maybe I'd get \$25 for it. Which made me wonder, would I be making a \$25 or losing \$475? And at the end of the garage sale, when our cash box is clinking with quarters, nickels and dimes, will we be making money by selling these items at such low prices or should we mark the prices higher based on their current market value? Or is it even worth our time to sit in the front yard all day hawking them when we could save time by calling the local charity to pick it all up?

So it goes with the pricing of service parts. In fact, the pricing of service parts has been more of an art than a science. Re-active rather than pro-active. Tactical rather than strategic.

Most OEM's formulate pricing decisions by calculating the relationship between incurred costs and desired profits, which is called a cost-plus approach.

But this antiquated approach fails to provide visibility and pricing management across all markets, lacks the ability to measure the effect of price changes upon demand or competitive response to price moves, allows for little collaboration with procurement, sales and partners, and fails to understand, track and incorporate competitive prices and gross margins. Leading companies that have integrated new pricing technologies into their practice have appreciated an enormous – and almost immediate – return on investment – one that can be tracked and measured, unlike the "profits" from a garage sale. Consider the following areas of parts pricing improvement.

A world leader in the agricultural and construction equipment businesses relied on the cost-plus method to determine the price for service parts on their construction equipment. Their formula was simple: every quarter they increased the service parts prices; however, over time, they noticed that demand began to drop considerably. After a corporate mandate to increase service revenue, this OEM conducted in-depth market research to discover the source of decreasing demand. They found that the vast majority of their service parts were priced well-above the market averages across all categories. This overpricing attracted competitors to the market. And their competitors were beating them out because of the lower prices. Why buy an OEM part if there's one that's cheaper?

In order to increase demand for their parts, the OEM set up a program for market research to be conducted on a quarterly basis in order to bring prices back into the competitive zone. However, research was "set and forget" as there was no tracking of competitive response over time. Therefore, the spreadsheets were left to collect dust after just one use.

With the new pricing software solution in place, the construction equipment manufacturer can now systematically measure and calculate price sensitivity.



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In addition, the collected data wouldn't grow dusty on the shelf, but instead, it's used to forecast demand. Furthermore, the technology solution to determine how much sales volume would increase by lowering the price on a part. They used this data to negotiate with vendors to obtain cost concessions, but it's win/win for both vendor and OEM. Historical analysis can predict sales volume based on price decreases, so OEM and vendor can decide how much cost concession can benefit each other.

During a recent company status update, the aftermarket parts segment realized \$2.8M USD revenue increase for the quarter using a single large pricing policy. In the second quarter, the company realized over 3% in increased revenue, or over \$40M across all parts. Over \$2M can be directly attributable to increasing prices up to market levels for the handful of parts that turned out to be priced below competitive prices.

The pricing solution also enables differentiated market strategies. Without it, companies end up competing against themselves. For example, buyers will purchase parts in the US if the price is lower than in Europe. Since exchange rates change all the time, the current weak dollar doesn't help either. Then, they can re-sell them in the Europe market for cheaper than the OEM. Another aspect of parts pricing that is frequently mishandled is service contract pricing. Whether it be purchasing a new car or a new server, there's often a disconnect between sales and operations. So when the salesperson throws in a discounted service contract with your new office phone system, the company cannot determine if it's losing money or making money from that service contract as it includes not only the price of the service parts, but also the cost of the field technician's time and expertise. Historically, companies have not tracked whether these contracts have been profitable or not based on hard data. With a pricing solution, companies can track previous contracts and then forecast over the life of future contracts, including data on breakage rates, locations with higher usage, seasonality, and other customer requests to determine the profitability of the contract.

Another consideration for parts pricing optimization is the link between customer satisfaction and pricing. For example, a leading truck manufacturer gave away over \$60 million in sales allowances associated with dealer complaints, but the manufacturer had no idea whether the price adjustments increased or decreased profit on these sales allowances. Therefore, the truck manufacturer now has the ability to tie dealer complaints to competitive data points that will track the level of satisfaction and sales allowances with each price adjustment.

Couple pricing with service parts management and service workforce management, and OEM's have the recipe for transforming service operations from cost centers to profit centers.

In terms of selling my own service part at the garage sale, I ended up checking on-line and my discontinued, never-been-used, stainless steel boat propeller was selling for \$325. Maybe selling to my local neighborhood isn't the right strategy.

Mike Landry - Founder and CTO

As Founder and Chief Technology Officer for Servigistics, Mike is responsible for product strategy and business development. Mike has 20 years of experience delivering software and consulting solutions for service, most recently with Vantive. Since starting Servigistics in 1999, he has led the creation, development and implementation of the Servigistics solution for a roster of blue chip clients.

With Mike's visionary leadership, Servigistics has developed the industry's broadest and deepest Strategic Service Management solution, attracting many global market-leading clients and raising substantial capital. Today, Servigistics is the fastest growing company in the after-sale service software industry, with highly referenceable clients across high tech, aerospace, motor vehicles, medical, telecommunications, and consumer and industrial products.

Global leaders who have turned to Servigistics to improve customer service levels, drive revenues, and increase profits include companies such as ATR, Avaya, CNH, Credence, Dainippon Screen, Dell, EMC, Electrolux, Eurocopter, GE, Hamilton-Sundstrand, Hitachi, Home Depot, Honeywell, IBM, IKON, Johnson & Johnson, Juniper, Konica-Minolta, LG, Maytag, Mazda, Motorola, MTD, NACCO, Patterson Dental, Radiant Systems, StorageTek, Subaru, Sun Microsystems, Toshiba, the United States Postal Service, Volvo, and VW.

Mike holds a bachelor's degree in Computer Science from Georgia Tech and a master's degree in Economics from Georgia State University.