

*Using Intelligence to Set the Price-to-Win*



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by Michael C. O'Guin

*"Pricing is the moment of truth – all marketing comes into focus in the pricing decision."*

*– Raymond Corey, Harvard Business School 1962*

Not long ago, as a construction company executive was pulling into the California Department of Transportation (Caltrans) parking lot, he received a cell phone call from the company president. The executive was in that parking lot to deliver their \$650M proposal for a highway renovation project. The president had been fretting over their bid for weeks and had finally concluded it was too high. The president instructed the executive to take out his pen and lower their bid by \$30M. Weeks later, the president was thrilled to learn that they had won the contract, but stunned to find that their bid was the lowest bid, by over \$60M. The company president had literally written off over \$30M in the company parking lot just moments before that contract would be picked up. He made that decision with virtually no facts, only intuition. There must be a better way to determine pricing. There is, and it is called Price-to-Win and competitive intelligence is key.

## Conducting a Price-to-Win

Price-to-Win (PTW) is a market based analysis of an opportunity to identify the highest price a company can bid and still win. This formal process uses two sets of information – customer and competitor intelligence. Using customer intelligence, the PTW analyst deduces the customer's true buying behavior – when and under what circumstances is the customer willing to pay a price premium. Parallel with that, the analyst assesses the competitor(s) to understand what their most likely bid offering will be. The analyst then costs out the competitor's solution. In addition, the analyst assesses what investment the competitor is willing to make and how aggressively they will bid. Then the analyst puts themselves in the customer's position and determines where their company needs to put their price relative to the competition, based on how attractive the customer finds their offering vis-a-vis the competitor. By understanding what the competitor will bid and how the customer is likely to make their source selection, the PTW



analyst identifies the highest possible winning bid price with the right balance of capability.

Some managers are under the mistaken impression that a PTW is merely a justification for slashing profit margins, but it is not. PTW is a process for managing costs while maximizing win probability. Establishing an early market based price and subtracting out the desired profit margin, allows management to set and deploy cost targets for the offering. Likewise, while assessing what's important and what the competitor is offering, the customer provides the PTW analyst with the opportunity to find ways of adjusting their offering to make it more attractive to the customer, or influence the customer to weigh their discriminators more heavily in the selection decision. This can allow their company to bid a higher price and still win.

Without Price-to-Win, many companies allow costs, irrespective of competitive forces, to dictate pricing. Then suddenly as the proposal submittal nears, management decides their price is too high, a price which may not be based on substantive facts. To reach management's price, the capture team suddenly finds themselves desperately scrambling to reduce costs. The team frequently jettisons features and discriminators out of their proposal which they spent weeks and months selling to the customer. Likewise, management is forced to make painful decisions. To meet the desired price, executives are forced to slash profit margins, commit millions in investment, and take on significant risk jeopardizing their business case.

### Customer Analysis

Customers have consistent buying behaviors and understanding these behaviors is of critical importance. Their buying patterns help one identify the customer's true values in the source selection decision – if, how much and under what circumstances they are willing to pay a price premium. It is crucial to identify which situation you are in, to best configure your offering and avoid leaving “money on the table.” From historical analysis, you can project with a surprising degree of accuracy how the customer will evaluate the offerings.

The first step to successfully predict the customer's future purchasing behavior, is to analyze the customer's past purchasing history to identify buying patterns. You pore over past competition Request for Proposals, debriefings, lessons learned documents, and winner's press releases to identify and understand past purchases by the customer. Once this preliminary information is collected, you should find and interview participants in those competitions. From this study, you look to determine:

- How did the evaluation process work (who did what, when?)
- Who were the key players in the customer organization and how much relative influence did each have?
- What was the customer's stated evaluation criteria?
- What appeared to be the real customer's evaluation criteria?
- What did the competitors' do that had the most impact on the eventual outcome?
- How important was price in selecting the winner?
- What type of negotiations were conducted and were there more than one round?

You need to understand the context of each of these past procurements – how important was this competition to the organization's mission, what were the funding constraints and other environmental pressures on the organization when this procurement was made. Customers emphasize price differently when their budget coffers are flush versus facing a severe cash shortfall. Likewise, customers are much more willing to pay a premium for a higher



performing solution which addresses a significant mission shortfall than improve a support service.

From the customer analysis you determine where your price should be relative to the competition, as shown in Figure #1 for two different customers. For example, if your customer is Caltrans and they have a statute requiring them to select the lowest priced and technically acceptable bidder, then the winning price can be just one dollar less than the competitor's bid price. Unfortunately, no one is good enough to predict the competitor's bid within one dollar, so you should recommend a number lower than the expected competitor's bid by an amount inversely proportional to your confidence in estimating the competitor's bid. The more confidence that you have in your accuracy, the closer their PTW will be to the competitor's bid; the less confidence you have the more margin you need to bid lower than the competitor's price. However, NASA often awards to the higher priced bid. When selling to NASA, the winning price depends on how well your offering scores are on the proposal evaluation, relative to the competitors. The higher the score over the competition, the greater price premium you can sustain. Conversely, if the competition's score is higher, you must be much lower in price. Different customers have different buying behaviors and these behaviors determine where you should target your price relative to the competition.

## Competitor Analysis

Developing the PTW requires a thorough understanding of the competitor's approach. To win, one must devise a solution which differentiates themselves from the competition on those attributes most important to the customer. It is impossible to develop such a strategy without understanding the strengths and weaknesses of the competition's offering. Therefore, the analyst conducts a rigorous competitive analysis parallel with the customer analysis.

First, you assess each competitor's past bidding behavior. What win strategy does the competitor typically employ, technical features, low price, minimal risk, outstanding customer service? You use this information to help focus your analysis on how the competition is likely to behave – where and how are they likely to innovate? You identify when they've bid aggressively and when not. Don't merely use history as a predictor of the future. Look for patterns and discontinuities to understand the competitor's underlying behavior. For example, one competitor has just lost three bids in a row. The PTW analyst knew that the competitor was going to wake up and bid differently. Therefore, as the PTW analyst assessed the competitor they realized the competitor's existing business base was so precarious that unless they won the next bid they were going to have to close a large facility. This led the analyst to predict the competitor

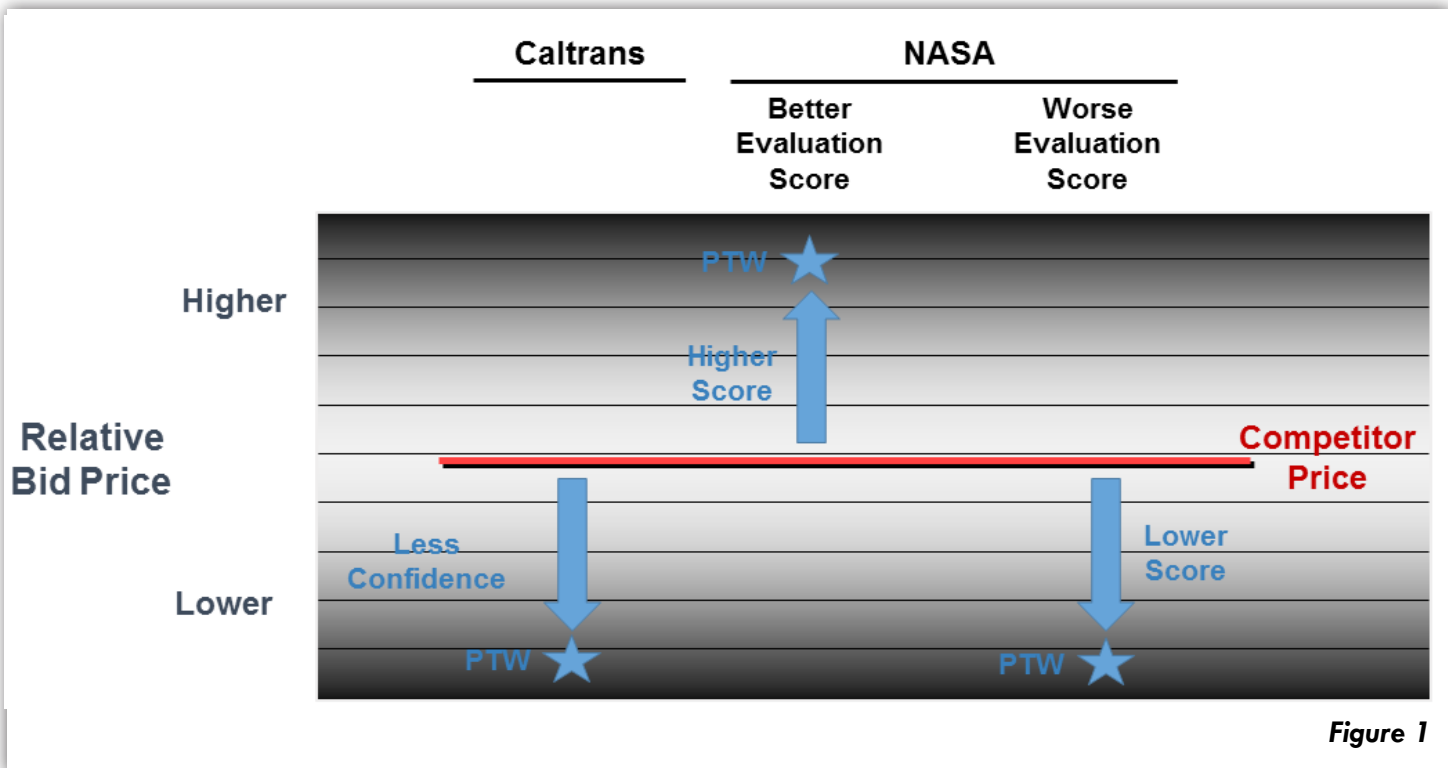


Figure 1

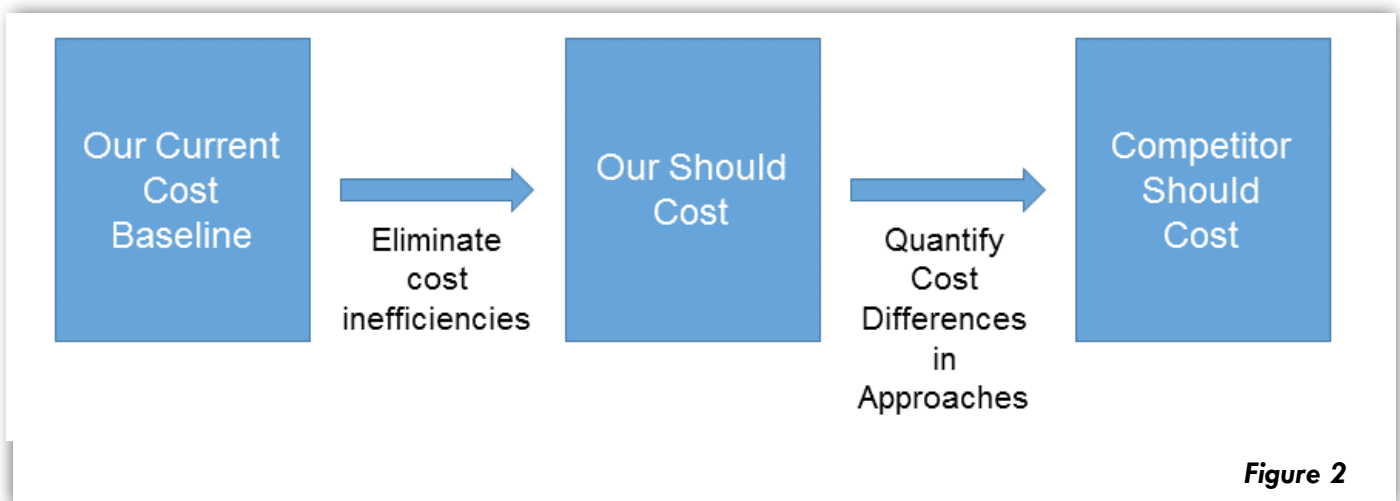
would break with their past bidding behavior and bid significantly lower to ensure a win.

The next step in the PTW process is to understand the company's current cost baseline. Your own company's staff has likely spent hundreds of hours engineering and estimating your solution for an upcoming bid. They have analyzed the market needs, environmental conditions, and customer requirements and then conducted dozens of trade studies to formulate a solution and cost it. You do not want to waste this information. In fact, it is illogical to believe one or two PTW analysts could replicate those hundreds of hours for the competition.

You build a cost model going down to the lowest level feasibly possible. You then conduct a detailed analysis of the economy and efficiency of your own proposed technical approach, program structure, and estimating methodologies to identify a should-cost. When this process is done effectively, it uncovers cost-saving ideas from across the capture team and company. You evaluate all of these factors against the customer's requirements to eliminate over-scoping, redundancies, unnecessary features, and poor bidding practices. By assessing the solution's costs versus the customer's likely evaluation scoring, you identify costly technical features which create minimal evaluation credit. For example, in one bid the company was sourcing all of their machined parts to a sister division in need of work. This sister

division was in a production lull and desperately needed the work. Unfortunately, these machined parts required relatively low skills and the sister division was not cost competitive. The PTW analyst then estimated the cost difference of using a cheaper machined part supplier and removed this cost from the current cost baseline to create the should-cost.

The next step in a competitive analysis is to deduce the competitor's likely solution architecture. Different architectures usually drive the major cost differences in bids, not variations in labor and overhead rates between contractors. You deduce each competitor's technical approach while adhering to strict ethical and legal standards. All companies broadcast their intentions to the marketplace by the signals they emit. They communicate their actions by whom they team with, who they hire, what components they buy, what messages they send, so on and so forth. By systematically seeking out these signals and piecing data together a snapshot of their offering will emerge. A vast array of diverse sources need to be combed for important information, including past bids, technical papers, marketing literature, financial statements, and press releases, while interviewing suppliers, financial analysts, test lab personnel and trade officials. The should-cost analysis directs the competitive analysis by identifying the key cost drivers, so the PTW analyst can focus on those technical differences that'll likely have the biggest effect on cost.



**Figure 2**

Once you deduce the competitor's technical approach, you replicate the should-cost model of your solution and begin making adjustments based on differences with the competitor. You use the should-cost as a baseline for creating the competitor's cost buildup since it reflects the program's requirements and should be free of all cost efficiencies. From the technical architecture, you are able to create a bill of material for all of the significant cost items. From the company's procurement personnel and open source literature, you can identify component costs for the bill of material items. For software, installation, and other labor tasks, an analyst works with engineering to estimate the man-months required for their solution and applies appropriate labor rates and burdens. The analyst takes all the materials, subcontractors, and burdened labor and applies estimates of the competitor's G&A and profit. You adjust this data for business considerations and bid aggressiveness as you try to "get inside the head" of the competitor's key decision-makers and anticipate their bidding approach and strategies.

While most customers provide the offerors with the evaluation criteria, unfortunately, you usually should be conducting their analysis well before the customer has published it or even designed it. In those cases, you must study the customer's past source selections and project how the customer is liable to evaluate this one. You will attempt to replicate the customer's likely evaluation criteria and weightings. You then try to objectively assess

each competitor's offering against the evaluation criteria and forecast their evaluation score. From this analysis, you are able to project which competitor is likely to receive the higher score and what is the magnitude of the advantage.

Integrating this information with the competitors' likely bid prices and analysis of customer's buying habits, you identify the highest price a team can bid and still win. If your solution is likely to receive a higher score than the competition (and the customer's buying behavior shows they are willing to pay a price premium) then the price may be set higher than the competitor's bid price. If your score is equal or less than the competitor then your team should set a PTW target below the competitor. This number is the "Price-to-Win" target.

However, the Price-to-Win process should not end with just providing a target, it should produce actionable recommendations for improving one's competitive position. A PTW is a comprehensive analysis which surfaces all of the critical competitive issues. It can provide executives with an unparalleled independent assessment of the capture team's win and pricing strategy. For example, during the course of our competitive analysis, while working on an Information Technology implementation bid, we discovered the displays that the competitor and our team were bidding on, were the same display, but the customer was having field problems with them and had to pay a company to remove and replace those faulty displays. Feeding this information back to the capture team allowed our team to change display suppliers and provide a more attractive bid.

You should work with business management/finance to allocate the PTW target into cost targets for the designers and functional department heads. The targets are set to meet the overall PTW target while supporting the win strategy. Optimally, the PTW should be derived early enough to allow it to drive the solution architecture. The resulting cost targets should become design parameters. Cost targets must be deployed to a sufficiently detailed level for meaningful design-to-cost (DTC) targets. The cost targets must be defined at a functional level where accountability for their achievement can be assigned and tracked. Only by having the market-derived PTW drive product development can profit margins be maintained while creating a winning approach.





## **PTW Case Study**

We conducted a PTW analysis for a vessel tracking system bid to be installed at a large commercial port. A vessel tracking system consists of a control station connected to a series of radars to locate, identify, and track all ships in a port to avoid collisions.

First, we analyzed the customer. We reviewed press releases and articles about the port authority to identify significant purchases they had made over the last five years. Those articles gave us some clues on why some suppliers were picked. Then, we found a couple of local public officials to interview who were knowledgeable about the port authority and they were able to provide insight on their procurements. We found that despite the port authority's claims that they buy the best value, they had consistently chosen the lowest priced bidder, as long as the supplier passed the technical evaluation, which was usually pretty easy. In this case, our competitor was very technically competent and we were sure that they would be able to be compliant. Therefore, we concluded that we had to beat them on price to win.

Next, we analyzed our team's current cost baseline which priced up the sum of all of their functional cost estimates. Next the PTW analyst adjusted this baseline to eliminate expensive and unnecessary software development and hardware which could be proposed as future upgrades. In addition, the analyst added in missing bill of material items and revised some of the overhead factors to develop the should-cost (see Figure #3).

To develop the Competitor A's bottom up cost, the analyst studied system's cost drivers. One of the most significant costs of a vessel tracking system is the design and installation of the radar towers. From the competitor's marketing literature, the analyst found a picture of their radar, while a press release announced their radar supplier. Knowing the supplier and matching the picture to one on their web site allowed the PTW team to determine which radar the competitor would propose and its specifications. The competitor's radar was larger, more expensive and more capable than our team's. When the team's engineers overlaid the competitor's radar's capabilities on the port's geography they calculated that the competition would only need 20 radar towers to our 27. Tower hardware consisted of a radar, communication link up and wiring. Each tower required a geographic survey, foundation design, power

and communications interconnection design, and radar attachment. Each tower had to have a foundation sunk and a tower erected, but even with a heavier radar, the competitor's per tower erection cost would be the same as ours. We knew their tower design and erection costs would be the same per tower, because the waterfront construction community in this port was small and both teams were working with the same suppliers.

We compared the features in the competitor's marketing material to the customer requirements, we were able to identify what software functionality the competitor lacked. We worked with our engineering staff to estimate the competitor's cost of developing this new functionality. Likewise, the competitor used a different and more expensive approach to communicating with the towers. We worked with our communications supplier to estimate the recurring communications cost of the competitor's system for their 20 site installation.

When we analyzed the Competitor A's bidding history, we found a very consistent behavior – they rarely dived on pricing, did not amortize development costs and kept their margins relatively stable. Therefore, we concluded that the competitor would neither bid excessive margins or bid more aggressively than normal, with their typical margin. Since the cost of the "Tower Hardware," "Tower Location and Design," and "Tower Erection" was directly proportional to the number radar towers, Competitor A with fewer towers, having an over \$3.2 million price advantage, the company's current approach was going to fail (see Figure # 3).

When the PTW analyst presented this information, the team brainstormed on how to get their costs down to meet the competitor. One engineer came up with the idea of using existing towers or buildings instead of erecting new towers. The team went to work and discovered that with their smaller radar they could install their radars on ten existing structures. This approach eliminated the tower erection costs for ten towers. In addition, the tower location and design costs was significantly less expensive for an existing structure than a new site. This allowed the company to slash its estimate and increase its profit while staying well below the competitor's expected price, as shown in "New Approach" and win.

It is important to note that this is a simple representation of a PTW analysis. There is more analysis used to cross

check the results, and the cost analysis goes down to a very detailed level. These methods lead to accuracy in the analysis, giving executives confidence, so they can bid to win.

PTW is not simply about driving down price, it is about identifying all of the levers in the competition, to develop a strategy to maximize return while still winning. In the above case, the PTW analyst was able to identify their cost problem with sufficient time to develop an innovative solution. In another case, a company improved its offering by adding features which lead to an improved evaluation score and subsequent price premium. In another, the PTW/competitive analysis uncovered a significant discriminator of the competition. In that case, the company copied it and neutralized the competitor's advantage. In still another case, the PTW quantified a cost discriminator of the client which allowed them to bid a higher margin and win. With PTWs, companies are able to leverage competitive intelligence to innovate, bid higher, and win more.

Developing a Price-to-Win is one of the most actionable and beneficial uses of competitive intelligence. My firm recently completed a study of 40 major bid losses and found the leading cause afflicting 65% of proposals was the company targeted the wrong bid price. In half of these cases, the bidders did not understand the customer,

and in all the cases the bidder underestimated the competition. Bidders need more effective intelligence, not just on the competition, but on the customer as well. More effective intelligence directly effects a company's win rate and therefore its growth and profitability.

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#### ABOUT THE AUTHOR:

**Michael O'Guin** has assisted clients in winning over contracts worth over \$367 Billion. Since forming his company, Knowledge Link, in 1993 he has worked on a hundred capture efforts, performing PTWs, training capture teams and guided their win strategy development. He and his partner Kim Kelly conducted the PTWs for the two largest awards in history – Lockheed Martin's Joint Strike Fighter pursuit and Northrop Grumman's KC-135 Tanker Replacement Program. When he was with Price Waterhouse, he led a two-year strategic benchmarking study of 24 aerospace & defense companies to identify best industry practices. He authored the books – *Winning the Big Ones: How Teams Capture Large Contracts* and *The Complete Guide to Activity-Based Costing*.

|                                          | Our Current Cost Baseline | Our Should Cost | Competitor A | Our New Approach |
|------------------------------------------|---------------------------|-----------------|--------------|------------------|
| Tower Hardware                           | \$945                     | \$945           | \$952        | \$945            |
| Tower Location and Design                | \$5,535                   | \$5,535         | \$4,100      | \$3,835          |
| Tower Erection                           | \$12,150                  | \$12,150        | \$9,000      | \$7,650          |
| Control Station Equipment & Installation | \$210                     | \$120           | \$165        | \$120            |
| Communications                           | \$130                     | \$130           | \$240        | \$130            |
| System Development                       | \$4,800                   | \$3,900         | \$5,100      | \$3,900          |
| System Integration & Test                | \$2,099                   | \$1762          | \$2,404      | \$1,176          |
| Port Specific Software Development       | \$2,698                   | \$2,590         | \$2,184      | \$2,590          |
| Other (PM, G&A, etc.)                    | \$9,803                   | \$9,364         | \$8,913      | \$7,149          |
| Profit                                   | \$6,139                   | \$5,110         | \$5,289      | \$7,020          |
| Total                                    | \$44,510                  | \$41,606        | \$38,347     | \$35,102         |
| Number of Sites                          | 27                        | 27              | 20           | 27               |
| Number of New Towers                     | 27                        | 27              | 20           | 17               |

**Figure 3**