Executing a **Total Solutions** Strategy

And Other Complex Selling and Pricing Structures

Contents:

A CIT White Paper

Part 1 Abstract

In nearly every industry, the effects of globalization and rapid advances in technology have delivered hyper-competition resulting in product commoditization and an inability for companies to sustain long-term competitive advantages. In this environment, companies in highly competitive markets face additional headwinds from clients who have become more discriminating and less interested in acquiring standard, one-size-fits-all products. Instead, clients demand products and services with greater customization to better fit their needs. In response, many companies have attempted to shift away from traditional product-focused strategies and have moved to a “Total Solutions” strategy and a customer-centric orientation.

Much has been written in business literature and academia about how companies and entire industries are reinventing themselves through a Total Solutions strategy. Despite all the in-depth explorations, little can be found on key product structures and administrative requirements necessary for any Total Solutions offering.

Following a brief review of the evolution from standalone products to Total Solutions, this white paper will explore the following requirements and provide considerations for companies who are pursuing a Total Solutions strategy.

Product Structure Requirements

- Maximizing margins and customer appeal of an offering through a combination of usage-based, variable and fixed pricing structures.

- Partnering with third-party suppliers to fill gaps in a company’s offering to create true Total Solutions that address the entire spectrum of customer needs.

Administrative Requirements

- Creating billing systems that customers can trust and invoices that clearly show how costs were determined for every charged item.

- Ensuring that the accounts receivable/payable system can receive and identify charges due and allocate payments to the company’s internal divisions and third-party suppliers.

Introduction

A recent in-depth survey of 2,700 executives and managers from 50 countries revealed that 80% of companies are facing increased pricing pressure from customers and competitors.[1] Further, the survey found that profits rise sharply when C-level executives take an active role in pricing. Similarly, higher profits and revenues can occur when C-level executives get engaged in product strategy. Failing to defend product differentiation on values critical to customers is a path to commoditization. No matter the industry, product or service, commoditization is a constant threat to margins as well as revenue growth.

One strategy to combat commoditization is to change the rules of engagement in your industry by innovating on the product structure: what you sell, who you partner with and how you address the larger needs of customers.

Part 2 The Evolution of Product Strategy

Historically, most companies were product-centered, meaning they focused more on making the perfect product to maximize their profit rather than the perfect product to maximize customer needs. Until fairly recently, the product lifecycle consisted of three predictable phases.

Phase I: Innovation

You introduce a new product that fits a unique niche in the market. Competition is limited. Customers are abundant and margins are rich.

Phase II: Competition

New entrants enter your space, putting pressure on sales and margins by making improvements along the value chain (e.g., low-cost, low-benefit offerings that target the mass market; or new combinations of price and unique benefits that target specific customer segments) or by investing in such areas as distribution network, sales resources, promotions and advertising.

Phase III: Reinvention

You attempt to reinvent your product—usually by playing catch-up with me-too features and benefits or by leap-frogging competitors in some manner. However, pressure to innovate and maintain a sustainable competitive advantage continues.

In the 1990s, more companies realized that the traditional product lifecycle failed to break their offerings out of a state of continuous commoditization. At some point during the Competition or Reinvention phases, successful companies made the strategic switch from being product-centered to being customer-centered. This shift led to the creation of a new strategy for the Reinvention phase: Total Solutions.

[1] Global Pricing Study, Nov. 2012, Simon-Kucher & Partners

Customer Centricity & Total Solutions

In conjunction with the product lifecycle, companies have shifted their strategy from standalone products and services… to product "plus" complementary products or services… to Total Solutions.

Standalone Sales

Initially, companies typically sell a standalone product, which is standardized to appeal to the broadest number of customers. The simplicity of this product makes it easier for competitors to replicate. Products are sold individually to address a single-purpose customer need. For example, purchases of copiers, medical devices, computers, telecommunication systems, trucks, cranes, machinery and so forth are often one-time events.

Related in-house products and services may be sold to the same customer. Fundamentally, however, no meaningful additional revenue will be earned from the original sale until the core product needs to be replaced.

"Product Plus" Sales

As competition heats up, companies attempt to differentiate their offerings with a "Product Plus" strategy of bundling additional features, products and services. They may acquire other companies to enhance their product offerings, for example. Despite the broadening of the offering, the product structure remains relatively simple, comprising almost exclusively in-house offerings, and fails to provide a sustainable competitive advantage.

Total Solutions Sales

When the "Product Plus" strategy fails to slow down the competition, some companies and sometimes entire industries decide to embrace a Total Solutions strategy (e.g., nearly all copier manufacturers have attempted to move to managed print services in recent years). This product structure is customer-centric, complex and customized for each client, making it difficult for competitors to displace the incumbent.

Customers usually are deeply engaged in defining the product need and shaping the solution. The product is characterized by multiple components, from hardware and software to services and supplies. Each component may have a unique pricing structure: fixed or variable, consumption/usage-based, subscription-based, one-time or reoccurring charges.

For instance, an IT managed service provider may structure its Total Solutions to include hardware, applications and systems management, supplemented by third-party solutions for web hosting, cloud storage, application development and network services.

"True" Total Solutions Sales

A more recent trend in Total Solutions is made possible through sophisticated invoicing and accounts receivable/payable systems. In what is being called "True" Total Solutions, this sales strategy is differentiated by its inclusiveness of third-party companies whose capabilities and existing customer relationships are leveraged to form synergistic offerings and pricing options competitors cannot match.

A historic challenge of such structures has been the lack of capabilities of traditional sales origination, accounting, receivable/payable and invoicing systems to process a multi-faceted, multi-partner offering. Despite this challenge, companies eager to realize the revenues proceed with the strategy.

In such cases, these companies find that the only way to manage transactions is through manual processes, which eat into profitability through higher operating expenses. Further, the manual workarounds are inherently error prone and negatively impact internal controls as well as customer satisfaction.



	Standalone Product	Product Plus	Total Solutions
Strategic Focus	Product Centered	Product Centered	Product Centered
Competitor Imitation	Easy	Easy	Hard
Product Sophistication	Standardized	Standardized Bundles	Customized
Product Structure	Simple	Simple	Complex
Third-Party Solutions	No	No	Yes
Sales Structure	Simple	Simple	Highly Complex
Invoice Requirements	Simple	Simple	Highly Complex
Receivable/Payable	Simple	Simple	Highly Complex

As the chart above shows, Total Solutions introduce complexity to the product structure (i.e., sale elements and suppliers of those elements); sales structure (i.e., charges that are fixed or variable, usage-based, reoccurring); invoice requirements and receivable/payable requirements. Not included in the chart above but particularly important is accurate and timely handling of applicable taxes. Determining a solution's tax qualifying activities in multi-state and multi-national accounts is particularly daunting for any organization.

The investment required to overhaul a company's systems to support Total Solutions is so significant that few venture into it until the ROI is compelling. But companies do have an option. By offering financing as part of the Total Solution, they can engage their finance partner to address some or all of the process and system requirements of complex product offerings. Moreover, a compelling financing solution can be critical to winning new business.

Whether your company is selling complex structures today, such as usage-based, complex bundles of products and services, managed services or Total Solutions, the following considerations may be helpful as your product offering evolves and your company seeks to build a sustainable competitive advantage.

Part 3 Product Structure and Administrative Considerations

As indicated earlier, the scope of this paper is to provide insight and direction on four key requirements of complex pricing structures. The first two requirements relate to product structure. The second two are administrative capabilities.

Product Structure Considerations

- Maximizing margins and customer appeal of an offering through a combination of usage-based, variable and fixed pricing structures.
- Partnering with third-party suppliers to fill gaps in a company's offering to create "True" Total Solutions that address the entire spectrum of customer needs.

For most companies, a critical transforming aspect of building pricing structures is developing deep customer insight through discussions with multiple stakeholders at different levels. This knowledge provides you with guidance on selecting sales structures and pricing that you can propose with confidence.

Usage-based pricing structures are popular in complex solutions. These consumption-based, variable pricing structures can be adjusted to accommodate nearly any situation and provide opportunities to capture unrealized revenue through higher margins or sales of additional products, services or supplies.

Three usage-based systems are common:

Tiered: Customers agree to a certain usage level each period and pay more if that level is exceeded.

Options include:

- Customers may or may not get rollover credit for unused usage.
- Each usage tier is priced separately. Customers may pay the full price of each tier as they progress through the tiers; or only pay the price of the highest tier achieved, which is priced lower than earlier tiers.

Unlimited: Customers agree to a fixed price for unlimited usage.

Pay As You Go: Customers pay only for what they use and may or may not have a minimum purchase requirement during each period.

As the "Usage Factor Examples" sidebar on page 8 shows, usage can be based on any measurable factor—providing you with exceptional ability to build customized pricing structures difficult for competitors to uncover and sell against.

The challenge of delivering a complete total solution is having the full arsenal of required products and services. A company can only develop so many of those resources organically or through acquisition. By contrast, however, partnering for the purpose of fulfilling the solution is a simple strategy.

While the strategy may be simple, administrative execution typically is difficult and requires manual operations and the creation of new processes. Your partners need clarity and transparency on how their offering is being consumed, charged and paid. That requirement will be explored next.

Administrative Considerations

Complex selling structures have two key administrative objectives:

- Creating billing systems that customers can trust and invoices that clearly show how costs were determined for every charged item.

- Ensuring that the accounts receivable/payable system can receive and identify charges due and allocate payments to the company's internal divisions and third-party suppliers.

Billing systems for complex solutions must start with profiles of each billable item. These profiles identify the provider of the product/service, asset/charge type, asset/charge description, pricing matrix and tax status/rate, and may include information such as contracted usage amount/charge, overage usage rate, serial number, location and/or customer cost center. Non-assets such as services, shipping and handling charges, supplies and fees also require profiles.

Invoice rules need to be created for each customized selling structure. These rules attempt to account for every possible situation that can occur in determining amounts due. Usage-based structures require a number of rules such as the number of days early or late that usage can be reported for an invoice cycle and how to process questionable reported and non-reported levels. Your partners may also require certain invoicing rules related to their charges. Invoice messaging also ties in to the rules and should automatically appear to explain non-standard charges.

Other invoicing requirements include:

One Invoice: Customers need the simplicity of a single invoice that provides both a summary of all major components of the solution along with the detail behind the charges.

Content & Design: Invoices should be designed so customers can easily understand the charges and how they were calculated. They should allow for segmentation according to customer preference and the ability to include messaging for special explanations or helpful information. Clear and intuitive invoice design increases timely payment from the customer, which can help your cash flow.

Marketing & Notices: Invoices should include the option to provide unlimited 1:1 or "one to many" messaging, advertising, policy/regulatory notices and other communications to invoice recipients.

Electronic Invoices: Electronic invoices should be available for clients who prefer paperless documents.

Consolidated Invoices: Customers should have the option to consolidate other contracts into a single invoice.

Cost Allocation Splits: Customers should have the ability to apply internal cost center codes directly to their invoices whether for single, multiple or permanent frequency.

Charge Dispute and Resolution: Systems should provide real-time adjustments to invoices that indicate disputed items and remove those charges from the bill until they are resolved. This encourages timely payment for the undisputed charges and increases customer satisfaction.

Customer Invoice Inquiries: Systems should be able to produce reports that indicate the names and frequency of customer inquiries on specific topics.

Spreadsheet Invoicing: Some customers require invoices in spreadsheet format to allow them to organize the charges for their own purposes.

Mark for Review: For times when the customer disputes certain charges or when you want to view "what if" scenarios should components of the current offering change, the system should produce an invoice and release it upon confirmation from the customer or you.

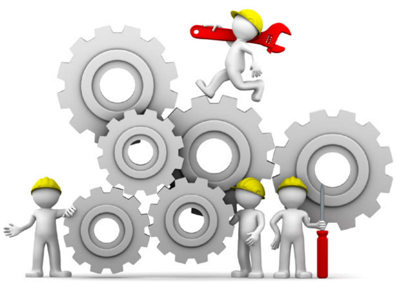
Usage Factor Examples

Usage can be based on any measurable factor, such as:

- **Meter Based**: Charges based on count.
- **Location Based**: Charges vary depending on location.
- **Time Based**: Charges vary depending on the time of day, day of the week, season, etc. (e.g., lower rates when use is during off-peak hours).
- **Product or Application Based**: Charges based on usage of distinct products, applications, performance (e.g., high bandwidth vs. low bandwidth) or other categories/segments (e.g., Internet access: social networking sites, streaming music, streaming movies).
- **Unit of Work (UoW) Based**: A pricing schedule identifies the price for each unit of work consumed (e.g., in a simple two-part UoW structure, the customer pays an initial fixed fee for the first set of units then a different price for each subsequent unit or bundles of units).
- **Device Based**: Charges vary depending on the equipment, devices or methods employed to use the product/service.
- **User Based**: Charges based on the number of users that are entitled to use or actually use the product or service.
- **Performance Based**: Charges based on how well the product/service meets contracted performance/service levels or outcomes/results.
- **Promotion Based**: Charges may be lower during a designated period during the contract term.
- **Asymmetric Price Transmission**: Charges vary with upstream price changes (i.e., inputs for processing or manufacturing) that increase or decrease downstream prices. This approach is attractive to sellers when their cost to deliver their offering is unstable and out of their control.
- **Combinations**: Charges may be combinations of methods with certain activities being unlimited or usage-based and others with usage caps.

Accounts Receivable/Payable Systems

Even with the best invoicing capabilities, companies selling complex product structures require sophisticated accounts receivable/payable systems. These systems must have the capability to accurately capture usage data each period, create a receivable on each asset, apply complete and partial payments, and accurately allocate payment to other internal divisions and to third-party companies.



A challenge for structures with usage-based attributes is automating the capturing and registering of actual usage levels each invoice period. Fortunately, many software companies have solutions to address this challenge.

Another challenge is determining how to handle incomplete, missing or questionable usage data. Again, systematic solutions are required to avoid the cost of manual intervention. Below are sample business rules for these situations that the accounts receivable/payable system should incorporate.

Usage Prorated: When usage levels are not submitted on time, estimates are calculated based on averages of previous use and credits or debits are applied.

Rollover Until Full: All excess calculations are performed against the total pool allowance, notwithstanding missing usage updates. Any unused allowance is rolled over to the next billing cycle. The rollover resets each time a full set of usage reads is received.

Bill on Complete Usage: No usage charges are included in the invoice until all assets with usage levels are submitted; this could result in $0 invoices and extraordinarily large dollar amounts due, which also delays client receipt of their monies for services rendered.

Traps to Avoid When Building Total Solutions

Total Solutions require in-depth knowledge of the customer objectives, strategies, market and internal situations.

The first trap to avoid when building Total Solutions is relying too heavily on one level of the customer's organization to validate the need and value of your offering. Your sales people must be consultative sellers and pursue building a network of contacts within the prospective client's organization. Sales people should involve multiple functional organizations within the customer as well as multiple levels within those groups to validate the need and construct the solution and pricing. The more they learn and understand about the client's pain points, needs and opportunities, the stronger the value of your company's recommended solution.

Another potential misstep is not actively helping customers during the decision-making process. In addition to working broadly and deeply inside the customer's organization, you should provide your customer with a comprehensive list of questions they should ask you and other potential suppliers. These objective questions should provide an avenue for you to ensure the customer's awareness and understanding of the nature of their need and the specific values of your solution.

Lastly, it's important to understand how your solution impacts the customer's bottom line. You should attempt to quantify this figure and validate it with the customer's finance leadership. Bringing the customer's finance team into the decision making process provides the credibility and confidence the company needs to move ahead with your solution.

Leverage Your Finance Provider's Systems

Ask your finance provider how they can assist you in building and administering complex structures like Total Solutions. Specifically, find out:

- Can they support the product and pricing structures or combination of structures that you are considering?
- Do they have a limit on the number of usage items their systems can process?
- What elements do they include in creating profiles of each itemized charge?
- How do they determine whether an item is taxable and at what rate, and how do they handle taxes due in states that charge taxes up-front versus in arrears?
- What type of IT assistance do they provide to map data flows with each division of your company involved in the sale, your partners and the finance company itself?
- What are their ideas to increase revenues and margins on financed transactions?
- What reporting and analytics do they provide to you, your partners and your customers?
- Are there any limitations in their invoicing capabilities that would restrict the product structure you want to sell?
- Can they provide 1:1 messages, situational messages or advertising into the invoices?
- Do customers have the control to assign cost centers to the invoices?
- How do they handle customer disputes on invoice charges?
- What are your options for determining charges on usage-based items when the usage is not reported?
- How are major accounts serviced (i.e., single point of contact or larger team)?
- How are finance documents modified to best explain the sales and pricing structure and the contract terms and conditions?

Part 4 Summary & Implications

- The global economy and technological advances are making it increasingly difficult to maintain defensible margins and product differences.
- 80% of companies are facing increased pricing pressure from customers and competitors.
- Traditional pricing and selling strategies force companies into a state of "continuous commoditization."
- Total Solutions sales structures break the commoditization cycle through the customization of the offering and by addressing broader customer needs.
- "True" Total Solutions are being made possible by advances in invoicing and accounts receivable/payable systems, allowing companies to more easily incorporate the offerings of other companies to fill gaps in their own offerings.
- Significant capabilities are required of invoicing and accounts receivable/payable systems when offering complex sales structures like Total Solutions. These capabilities can make or break the success of the offering and must be addressed prior to product launch.
- Companies considering a Total Solution or complex sales offering should consider engaging a finance company to determine if they can provide the systems and process capabilities for the offering. By leveraging the finance provider's experience and systems, a company can be better positioned to meet the sales structuring and administrative needs of a complex offering.

Total Solution Platforms, combined with C-Suite direction, enhance profitability by up to 50%, according to the *MIT Sloan Management Review.*

FlexAbility products from CIT provide clients with unlimited options to structure what they sell, how they charge for it and who they partner with. Companies that go to market with complex sales structures such as managed services, bundling and usage-based should talk to CIT to understand:

- How FlexAbility, combined with a financed offering from CIT, makes it possible for them to be more innovative in their sales and pricing structures; and
- How FlexAbility makes administration of these structures easier, more accurate and at lower operational expense from order entry through accounts receivable.

FlexAbility is designed for manufacturers, software developers, service companies, managed service providers, systems integrators, distributors, dealers, resellers and end-user companies who use financing to sell or acquire products. FlexAbility makes it possible for CIT clients to maximize revenues, improve customer experience and build competitive differentiation.

By simplifying the initial funding process and lifetime payables administration of a financed offering, CIT removes the primary operational roadblock that prevents companies from implementing Total Solutions and other complex sales structures. Using FlexAbility, clients can confidently expand their offering to include products and services of other internal business units as well as third-party companies.

For additional information on **FlexAbility**:

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