Pricing in the Container Shipping Industry

March 2010
Executive Summary

• As the world economy is stabilizing, uncertainty remains in the freight industry; though the container shipping market is predicted to grow, rates are not expected to improve, leading carriers to respond by decreasing capacity.

• APL faces pricing challenges unique to the container shipping industry. Pricing is volatile and the rate formula is complex due to the need to balance transaction and network level variables.

• As a result, freight carriers face common pricing pitfalls due to unclear visibility into customer values and inability to price dynamically.

• High performance pricing is focused on deploying a “closed loop” capability including strategy, process, organizational change and supporting technology.
As a leading container shipping company, APL is the physical link between shippers and customers in the freight and logistics value chain.

### Global Freight and Logistic Landscape

<table>
<thead>
<tr>
<th>Shipper</th>
<th>Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retailers</td>
<td>Nordstrom</td>
</tr>
<tr>
<td>Manufacturers</td>
<td></td>
</tr>
<tr>
<td>Wholesalers and Distributors</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Mail and Express</th>
<th>Freight Forwarding &amp; Logistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Postal</td>
<td>Freight Forwarding</td>
</tr>
<tr>
<td>United States Postal Service</td>
<td>DSV</td>
</tr>
<tr>
<td>La Poste</td>
<td>Expeditors</td>
</tr>
<tr>
<td>Deutsche Post</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Logistics</td>
</tr>
<tr>
<td>Express</td>
<td></td>
</tr>
<tr>
<td>FedEx</td>
<td>Ryder</td>
</tr>
<tr>
<td>DHL</td>
<td>DB Schenker</td>
</tr>
<tr>
<td>TNT</td>
<td></td>
</tr>
<tr>
<td>UPS</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Freight</th>
<th>Sea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Road</td>
<td>Moving Business Forward</td>
</tr>
<tr>
<td>DSV</td>
<td>APL</td>
</tr>
<tr>
<td>Kuehne Nagel</td>
<td></td>
</tr>
<tr>
<td>Expeditors</td>
<td></td>
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<tr>
<td>Schenker</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Hapag-Lloyd</td>
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<tr>
<td></td>
<td>FedEx</td>
</tr>
</tbody>
</table>

Sea | Air |
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MOL</td>
<td>Kitty Hawk</td>
</tr>
<tr>
<td>CMA CGM</td>
<td></td>
</tr>
<tr>
<td>COSCO</td>
<td></td>
</tr>
<tr>
<td>Maersk</td>
<td></td>
</tr>
</tbody>
</table>
Even as the world economy is stabilizing, uncertainty remains in the freight industry

- Freight industry has historically experienced adverse effects in financial results due to economic recession, downturns in business cycles of customers, fuel shortages, price increases for transportation by carriers, interest rate fluctuations, and other economic factors beyond individual control.
- Evolution of globalization is remapping the world economy forces the freight industry to respond to key change drivers.
- Though economic recovery continued to strengthen during 2010, volatility in financial, currency, and commodity markets remains elevated contributing to higher risk for the freight industry.
- Growth in trade and GDP is higher in developing markets - APL’s presence in Asia is a key strength.

GDP
GDP yoy change in %, 1992-2001 (av.)

Global Export Volume of Goods
Annual % change

Source: IMF
Though the container shipping market is predicted to grow, rates are not expected to improve, leading carriers to respond by decreasing capacity.

- Container shipping market predicted to grow by ~7% annually in the next five years.
- 2010 saw improvement in container shipping environment and rates, but it is unlikely that carriers will continue to gain such revenue improvements in 2011.
- Carriers to react by taking capacity out of the system and expected not return it until demand has shown the required upturn.
- Bunkers cost $543.50 /metric ton on Jan 14 in Singapore, 30% more than in May and the highest since October 2008.
- Slow steaming (container vessels now sailing at the slowest speeds in at least two years) will decrease fuel consumption and carrier capacity, increasing price.
### APL faces pricing challenges unique to the container shipping industry

<table>
<thead>
<tr>
<th>Container Shipping Industry Characteristic</th>
<th>Pricing Pain Points</th>
</tr>
</thead>
</table>
| Container shipping dependent on global trade, subject to economic fluctuations and is extremely seasonal | • Difficult to forecast demand  
• Periods of low demand leads to a buyers market |
| Pricing volatile and demand driven | • Pricing initiated by customer, rather than shipper  
• Need to monitor and constantly update price fluctuations |
| Business is asset heavy with fixed short-term physical capacity | • Difficult to adjust supply to match demand  
• Can only adjust capacity through changing sailing speeds, adding complexity to pricing formula with cost changes  
• Need to maximize asset utilization through effective pricing |
| Global trade flows imbalanced, leading high repositioning costs | • Need to balance profitability of overall network vs. that of individual contracts |
| Fuel cost and is unpredictable | • Cost management difficult  
• Volatile margins |
| Combining various types of cargo on a ship requires consideration of not only weight & volume but also storage, placement and handling | • Special requirements adds to cost and customer willingness to pay  
• Increases complexity of pricing formula |
The container shipping pricing formula is complex as it needs to balance transaction, vehicle / route and network level variables.

**Freight Pricing Formula Variables**

<table>
<thead>
<tr>
<th>Contract-Level Variables</th>
<th>Vehicle / Route-Level Variables</th>
<th>Network-Level Variables</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cargo Size</strong></td>
<td><strong>Mode / Geography</strong></td>
<td><strong>Network capacity</strong></td>
</tr>
<tr>
<td>Volume (FCL, LCL, Oversized), weight, container type</td>
<td>Mode (sea, rail, road), ports (departure, arrival)</td>
<td>Filled capacity, forecasted global demand</td>
</tr>
<tr>
<td><strong>Distance &amp; Speed</strong></td>
<td><strong>Vehicle/Route Capacity</strong></td>
<td><strong>Allocated Cost</strong></td>
</tr>
<tr>
<td>Speed required, distance, guaranteed on-time delivery</td>
<td>Total capacity, filled capacity, forecasted demand, sailing speeds</td>
<td>Fuel, stevedoring, repositioning, crew, maintenance</td>
</tr>
<tr>
<td><strong>Storage &amp; Handling</strong></td>
<td><strong>Allocated Cost</strong></td>
<td></td>
</tr>
<tr>
<td>Perishable, refrigerated, hazardous</td>
<td></td>
<td>Fuel, stevedoring, repositioning, crew, maintenance</td>
</tr>
<tr>
<td><strong>Customer Variables</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Volume discount</td>
<td></td>
<td>SG&amp;A, terminal operations costs</td>
</tr>
<tr>
<td><strong>Additional Charges</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BAF, peak season, CAF, THC</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Examples:**

- **Additional Charges**: BAF, peak season, CAF, THC
- **Customer Variables**: Volume discount
- **Distance & Speed**: Speed required, distance, guaranteed on-time delivery
- **Storage & Handling**: Perishable, refrigerated, hazardous
- **Cargo Size**: Volume (FCL, LCL, Oversized), weight, container type
- **Mode / Geography**: Mode (sea, rail, road), ports (departure, arrival)
- **Vehicle/Route Capacity**: Total capacity, filled capacity, forecasted demand, sailing speeds
- **Allocated Cost**: Fuel, stevedoring, repositioning, crew, maintenance
- **Network capacity**: Filled capacity, forecasted global demand

Note: List non-exhaustive
Due to this level of complexity, freight carriers face common pricing pitfalls

<table>
<thead>
<tr>
<th>Pricing Pitfalls</th>
<th>Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focusing on transaction revenue rather than optimizing overall contribution of network and profitability</td>
<td>Poor capacity planning and asset utilization resulting in lowered overall profitability</td>
</tr>
<tr>
<td>Lack of dynamic pricing capabilities</td>
<td>Poor response to market fluctuations, leading to under / over pricing</td>
</tr>
<tr>
<td>Equating customer size to value</td>
<td>Destroying value by keeping large customers that, though revenue is large, are unprofitable, and / or spending too much time and effort on numerous small volume, low margin customers</td>
</tr>
<tr>
<td>Using a standard cost + margin formula to determine pricing for every contract</td>
<td>Leaving margin on the table as different customers value different elements and some are willing to pay more for services</td>
</tr>
<tr>
<td>Unclear visibility into actual costs or improper allocation of cost by customer and/or route</td>
<td>Improper action taken toward rationalizing certain customers, routes and services (and keeping unprofitable ones)</td>
</tr>
<tr>
<td>Sales incentives not aligned to maximize profits through pricing</td>
<td>Sales teams unnecessary discount to get the sale, leaving margin on the table</td>
</tr>
</tbody>
</table>
High performance pricing is focused on deploying a “closed loop” capability including strategy, process, organisational change and supporting technology.

Accenture’s Pricing Capability Framework

- **Pricing Strategy**
  - Industry Pricing
  - Business Objectives Alignment
  - Price Positioning

- **Pricing Analytics**
  - Customer Value Analytics
  - Competitive Pricing Intelligence
  - Cost Analysis
  - Supply / Demand Planning

- **Rate Setting**
  - Direct / Indirect Cost Allocation
  - Pricing Optimization
  - Rate Case Development
  - Rate Endorsement & Approval

- **Price Mgmt & Execution**
  - Proposal Development
  - Price Communication & Messaging
  - Price Administration & Transaction Mgmt

**Pricing Governance**
- Pricing Roles & Responsibilities
- Leadership Focus & Pricing Competence
- Rewards & Incentives Management
- Stakeholder Management
- Monitoring & Scorecard Reporting

**Pricing Data Infrastructure**
- Access
- Capture
- Aggregation
- Enrichment
- Presentation & Distribution

- Pricing strategy aligns with business objectives
- Analytics employed to fully understand customer price behaviour and cost
- Proper rate setting based on customer value and segmentation
- Effective execution with standardized tools and processes
- Good governance with clear roles and KPIs in place
- Data and technology to enable high performance pricing
Pricing strategy should be aligned with market positioning and organizational objectives

**Pricing Strategy**

**Pricing Leading Practices**

- Set pricing strategy at senior executive level and align with overall strategic objectives and company capabilities.
- Establish clear positioning (e.g., technology leadership, price leader)
- Align channel pricing with channel value, define transparent rules, and ensure policies mitigate conflict between direct and indirect channels
- Establish overall service bundling strategy and explicitly communicate it throughout the organization
- Competitive benchmarking and price performance by customer segment are regular agenda items on senior executive strategic review sessions

**APL Differentiators**

- Seamless global connectivity
- Highly competitive transit times
- Industry-leading schedule reliability
- Extensive intermodal network to facilitate inland reach
- Two state-of-the-art intermodal terminals in the US West Coast
- Priority access to strategic Asian terminals
- Comprehensive fleet of vessels and modern equipment
- Integrated supply chain solutions with APL Logistics
- Excellent customer service widely recognized in the industry
- Vertical expertise who understand your special shipping needs

APL’s pricing should be aligned with its overall strategy and positioning, communicating to customers company capabilities
A strong analytic foundation with understanding of true costs & profitability is critical to establishing appropriate prices

Pricing Analytics

Pricing Leading Practices

- Establish centralized pricing group to develop deep statistical analysis capabilities

- Conduct comprehensive customer research and analysis encompassing price elasticity, customer value perceptions, and customer segmentation

- Establish real-time visibility into competitive pricing to enable rapid price adjustments

- Implement transaction-based cost allocation methodology – supported by a clearly defined service taxonomy and data architecture

- Use scenario modeling and/or price optimization software to predict competitor and customer response

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ILLUSTRATIVE

Customer Rate-Volume Analysis

Sample Customer Price Segmentation Drivers

<table>
<thead>
<tr>
<th>Customer Characteristics</th>
<th>Route Characteristics</th>
<th>Transaction Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Size</td>
<td>✓ Distance</td>
<td>✓ FCL vs. LCL</td>
</tr>
<tr>
<td>✓ Industry Vertical</td>
<td>✓ Mode</td>
<td>✓ Speed</td>
</tr>
<tr>
<td>✓ Revenue Contribution</td>
<td>✓ Vehicle Type</td>
<td>✓ Hazardous vs. regular handling</td>
</tr>
<tr>
<td>✓ Purchase Frequency</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Customers should be segmented by purchasing behaviour and treated differently in price setting.
Rates should be based on buyer perceptions of value and differentiated by customer segment and channel

Rate setting

Pricing Leading Practices

- Establish market relevant list prices through use of analytics and rapid adaptation to new market information
- Differentiate prices by customer segment and incorporate customer value perceptions into price-setting
- Consistently apply pricing rules and automate price adjustments
- Adjust channel pricing to achieve optimal channel mix and explicitly cost CTS elements (payment terms, etc.)
- Coordinate and clearly define price levers to understand aggregate effects on net price

Sample Buyer Value Analysis

Pricing to reflect customer value perceptions
Standardized tools and processes will ensure sales force compliance when performing price negotiations

**Price Execution**

**Pricing Leading Practices**

- Integrate supply-demand balancing across routes, network and customers into pricing decisions
- Establish negotiation price bands for sales force
- Reduce special pricing through clear discounting policies based on customer and channel cost-to-serve and volumes
- Provide sales tools to assess transaction profitability, including discounts, terms and value-added services
- Institutionalize ongoing customer-specific margin analysis, and implement action plans to address leakage
- Automate and standardize transaction management processes, with clear controls and streamlined approvals
- Seamlessly integrate information in price administration and other enterprise systems (e.g., ERP, CRM)

**Price Monitoring & Execution Control**

Sophisticated software tools can help to highlight opportunities in real-time and enforce consistent price management policies.
Establishing clear roles and accountabilities are important to ensure effectiveness in price execution

Pricing Governance

Pricing Leading Practices

- Establish clear roles, responsibilities and authority levels, with process to incorporate input from key stakeholder groups
- Create pricing scorecards to emphasize price discipline
- Streamline communication and make prices easy to access and use (e.g., direct feed to partners, monthly downloads)
- Set incentives that balance revenue and margin goals. Incorporate training on pricing, negotiation skills, and other pricing capabilities into broader sales programs
- Establish governance bodies to handle escalations
- Measure invoice accuracy and assign team to monitor contract compliance
- Track effectiveness of pricing changes and establish closed feedback loop with key decision-makers

Roles of Marketing, Sales & Pricing Group

Each team (e.g. Market, Sales, Pricing) should be given clear responsibilities in each stage of the price setting process
Use of a pricing software can allow APL to perform analytics, manage price execution and carry out reporting

**Pricing Data Infrastructure**

**Pricing Leading Practices**

- Create data warehouses and apply structure hierarchies to customer and product data
- Assign responsibility for maintenance to the users, but with centralized approvals
- Integrate key transactional, BI and operational systems; migrate data to industry standard databases and create ETL structures
- Effective migration planning should allow for interim process benefits

**Typical Pricing Software Capabilities**

<table>
<thead>
<tr>
<th>Capability</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>Price Analytics</td>
<td>Analytics (Waterfall, Time Series, Scatter Plot, etc.) to allow for identification of pricing and margin opportunities.</td>
</tr>
<tr>
<td>Pricing Management and Execution</td>
<td>Pricing lists and policy management (Maintenance, Control, Publishing and Communication)</td>
</tr>
<tr>
<td>Negotiation and Sales Enablement</td>
<td>Deal negotiation &amp; structure capabilities and supporting analytics/tools (Guidelines, Negotiation Options) to guide better deals</td>
</tr>
<tr>
<td>Price Setting and Optimization</td>
<td>Ability of the software to assist company to determine the optimized price or deal through pricing science and complex algorithms</td>
</tr>
<tr>
<td>Forecasting</td>
<td>Use a variety of methods for forecasting demand with respect to price (Forecasting Algorithms, Business Scenarios, Relevant Variables, Historical Transactions, Syndicated Data)</td>
</tr>
<tr>
<td>Workflow</td>
<td>Handle different types of processing with consideration to approval thresholds (deal workflow, line item workflow, automatic approval), history and notifications</td>
</tr>
<tr>
<td>Reporting</td>
<td>Out of the box reporting capabilities</td>
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Appendices
A wide range of pricing software vendors are available, dominated by a few core players with scale and more developed capabilities.

Pricing Software Vendor Landscape

- All vendors are moving towards broad pricing suites
- Price analytics is undifferentiated across vendors; however, differences exist in optimization approach
- Vendor solutions and focus differ by industry. Industry templates are becoming increasingly sophisticated and relevant in vendor selection
- The big ERP/CRM vendors are stepping in
- Implementation and integration effort remains significant
- Weaker / smaller vendors are starting to struggle and some are dropping out
- Vendors have built their foundation -- price admin, analytics and execution and are evolving to more detailed science, price setting and optimization
- Vendors are focusing more on the value chain integrating supply, demand, pricing and profit
- Software-as-a-Service and hosted solutions are beginning to evolve
Based on our experience working with leading vendors, PROs and Vendavo demonstrate the highest functional and technical capabilities overall.

<table>
<thead>
<tr>
<th>Capability</th>
<th>Software Company</th>
<th>PROs</th>
<th>Zilliant</th>
<th>Vendavo</th>
<th>Vistaar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pricing Analytics</td>
<td></td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Pricing Management and Execution</td>
<td></td>
<td>●</td>
<td></td>
<td>■</td>
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</tr>
<tr>
<td>Reporting</td>
<td></td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>○</td>
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<tr>
<td>User Interface</td>
<td></td>
<td>●</td>
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<td>●</td>
<td>○</td>
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<tr>
<td>Architecture</td>
<td></td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>Scalability</td>
<td></td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>○</td>
</tr>
<tr>
<td>ERP Integration</td>
<td></td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>○</td>
</tr>
</tbody>
</table>

Source: Accenture Analysis; see Appendix for detailed vendor descriptions.
PROS is a potential candidate with its advanced pricing science, focus on transportation and distribution industries and ability handle complex transactions

**Company Overview**
- Date Founded: 1985
- Based In: Houston, TX, USA
- Coverage: Global (43 Countries)
- Ownership: Public

**Product Overview**
- **PROS Price Management Suite**
  - **PROS Scientific Analytics (“SA”):** Provides the analytics to fully understand your business
  - **PROS Price Optimizer (“PO”):** Primarily used by pricing and product line managers, those charged with executing pricing strategies and maintaining / updating prices in play across the enterprise
  - **PROS Deal Optimizer (“DO”):** Field sales force negotiating tool. Comprehensive deal and line item scoring and configurable approval workflow

**Clients**
PROS has deployed over 350 solutions to over 100 clients including several industry-leading, Fortune 2000 companies.

**Observations**
- PROS delivers a mature end-to-end solution with strong algorithmic approach and pricing science
- Existing real-time solution for air cargo with revenue optimization and dynamic economic evaluation tools
- Consistently shown to have the best customer references
- Suited for companies with complex transactions and processes

Source: company website, Accenture analysis
Zilliant offers advanced optimization, tight integration and Software-as-a-Service

**Company Overview**

- Date Founded: 1998
- Revenue: Undisclosed
- Based In: Austin, TX, USA
- Coverage: Global
- Ownership: Private
- Market Focus: 100% focus on B2B manufacturing and distribution

**Product Overview**

Zilliant Precision Pricing Suite

- Zilliant Margin Insight™: Provides analytics for each role in the organization and for each type of pricing decision.
- Zilliant Margin Manager™: Delivers the Zilliant optimized prices, projected price and margin performance. Drives an exception workflow routing and approval process.
- Zilliant Margin Maximizer™: Establishes optimal prices for each line item on each transaction based on scientifically derived Precision Price Segments

**Clients**

Zilliant has over 50 customers to date, all B2B companies.

**Observations**

- Zilliant offers a Software as a Service model
- Sophisticated solutions for B2B pricing backed up by a strong research focus
- Leader in segmentation and optimization
- Zilliant is considered a leader in pricing science and ability to manage large data volumes

Source: company website, Accenture analysis
**Vendavo offers superior price execution and strong integration with SAP**

### Company Overview

<table>
<thead>
<tr>
<th>Date Founded:</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue:</td>
<td>Undisclosed</td>
</tr>
<tr>
<td>Based In:</td>
<td>Palo Alto, CA, USA</td>
</tr>
<tr>
<td>Coverage:</td>
<td>Global</td>
</tr>
<tr>
<td>Ownership:</td>
<td>Private</td>
</tr>
<tr>
<td>Employees:</td>
<td>200</td>
</tr>
<tr>
<td>Market Focus:</td>
<td>B2B - Chemicals, forest products, metals, industrial manufacturing, services, consumer goods, high tech</td>
</tr>
</tbody>
</table>

### Product Overview

**Vendavo’s Enterprise Pricing Suite**

- Price and Margin Analytics: Identify margin improvement opportunities
- Price Optimization: Set optimal prices and guidance across segments
- Price Setting & Administration: Set and administer prices and guidance efficiently
- Deal Execution: Negotiate deals consistently and profitably

### Clients

Vendavo has deployed their solution for 67 customers – all B2B, with combined revenues of over $223B.

### Observations

- Vendavo has a strong focus on B2B market segments, analytics and execution
- Considered a market leader in price execution capabilities
- Strong SAP integration capabilities, as well as with Salesforce.com and IFS
- Optimization module is relatively new with few customers in live production

Source: company website, Accenture analysis
Though Visaar has strong analytics and capacity forecasting capabilities, its industry focus is high tech and manufacturing.

**Company Overview**
- **Date Founded:** 2001
- **Revenue:** Undisclosed
- **Based In:** Parsippany, NJ, USA
- **Coverage:** Global
- **Ownership:** Private
- **Employees:** 135
- **Market Focus:** B2B / B2C – High Tech, Semiconductor, Medical products & Complex Industrial

**Product Overview**
- **Vistaar Solution (single integrated solution)**
  - **Price Strategy:** customer value assessment, competitor and market analysis, pro forma financials
  - **Price Setting:** Price optimization, segmentation, price list management
  - **Price Execution:** Sales ops support, deal evaluation, competitor and market analysis
  - **Product Portfolio Management:** Manage configured products, scenario planning
  - **Price Performance:** Waterfall analysis, price band analysis, discount tracking, profitability analysis, scenario planning

**Clients**
- Handful of clients in North America and Asia

**Observations**
- Tight integration with SAP
- Availability of demand and capacity forecasting capabilities
- Pricing solution is relatively new, having been in the market since 2006
- Small number of clients and lack of company maturity

*Source: company website, Accenture analysis*