



## Advanced Distributor Program:

### Pricing Strategies for Maximum Profit

Presenter

J. Michael Marks

INDIAN RIVER CONSULTING GROUP

[www.ircg.com](http://www.ircg.com)

## Download This Presentation

Go to [www.ircg.com](http://www.ircg.com)

1. From the IRCG Consulting Group home Page click on the Download Presentations Tab on the Home Page
2. Next, you will be redirected to a Login Screen. Provide your IRCG Username (**ISSA2011**) and Password (**pricing**) and click Login (web site is case sensitive)
3. If Username and Password match you will be sent to the downloads page for IRCG. Locate the Presentations Folder and single click the folder
4. Once on the Presentations Page navigate to the presentation that you wish to download. When you've located the file you want click the Download Button located directly below the file
5. A popup should appear asking if you want to save the file (note: popup may vary depending on the browser you are using when trying to download the file). Click on Save File
6. Finally, Go to the folder (on your computer) where the file was saved and double click the file to view.



## Dangers In The New Normal

- Average selling prices have dropped significantly in many industries reflecting economic circumstances
- Customer use of spot buying has increased dramatically taking advantage of fearful sellers
- Sales people are mentally on the defensive and afraid to lose orders so they often give away negotiating power
- Many sales people emotionally believe that they can regain lost revenue if they only can cut prices low enough
- No one can fix a market demand problem with lower prices
- Most of you can regain some margin where the discounting has been self inflicted



## Analytics: ROI

	2007 NAED		10% Sales		5% Expense		2 Point Price	
	Baseline	% of Sales	Increase	% of Sales	Decrease	% of Sales	Improvement	% of Sale
Revenue	\$ 100.00	100.0%	\$ 110.00	100.0%	\$ 100.00	100.0%	\$ 102.00	100.0%
Cost of Goods Sold	\$ 78.10	78.1%	\$ 85.91	78.1%	\$ 78.10	78.1%	\$ 78.10	76.6%
Gross Profit	\$ 21.90	21.9%	\$ 24.09	21.9%	\$ 21.90	21.9%	\$ 23.90	23.4%
Expenses	\$ 18.20	18.2%	\$ 20.02	18.2%	\$ 17.29	17.3%	\$ 18.20	17.8%
Sales	\$ 8.80	8.8%	\$ 9.68	8.8%	\$ 8.36	8.4%	\$ 8.80	8.6%
Operations	\$ 3.30	3.3%	\$ 3.63	3.3%	\$ 3.14	3.1%	\$ 3.30	3.2%
G&A	\$ 6.10	6.1%	\$ 6.71	6.1%	\$ 5.80	5.8%	\$ 6.10	6.0%
Operating Profit	\$ 3.70	3.7%	\$ 4.07	3.7%	\$ 4.61	4.6%	\$ 5.70	5.6%
Profit Improvement	\$ -	0.0%	\$ 0.37	0.3%	\$ 0.91	0.9%	\$ 2.00	2.0%
Percent Profit Improvement			10%		25%		54%	

This is real- but it is earned by making *investments* in analytics, processes, and real focus

Who is in charge of your pricing? If everyone, then no one is actually responsible



## Present State “One Size Fits All”

- Most supplier and distributor pricing activity is transaction based where

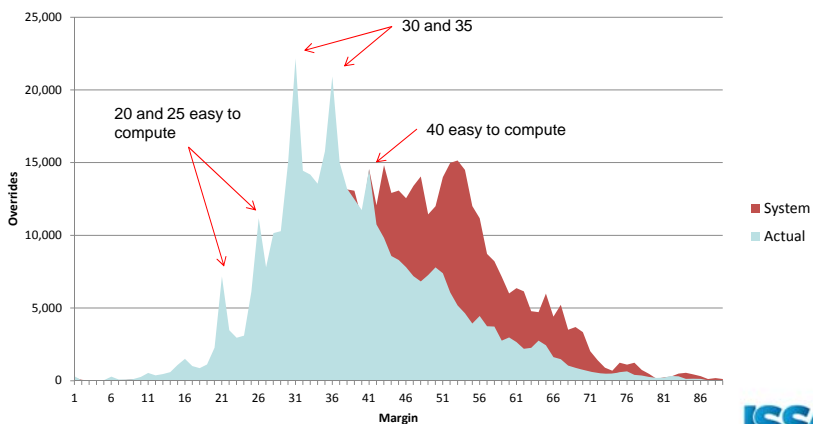
$$GM\%f(1/\text{Transaction Size})$$

- And LPP (Last Price Paid) rules
- Most ISSA members let sales reps determine pricing
- Distributor column prices are mostly used to give discounts to “large” customers
- Rebates are often added for capture or retaining large customers



## Key Mistake Number One

Not only do rushed people use easy numbers but they apply them to **everything** that a customer purchases or to **every** product in a suppliers line (This blanket response is very costly)



YTD Override Frequency: What is market based versus easy?



## Key Mistake Number Two

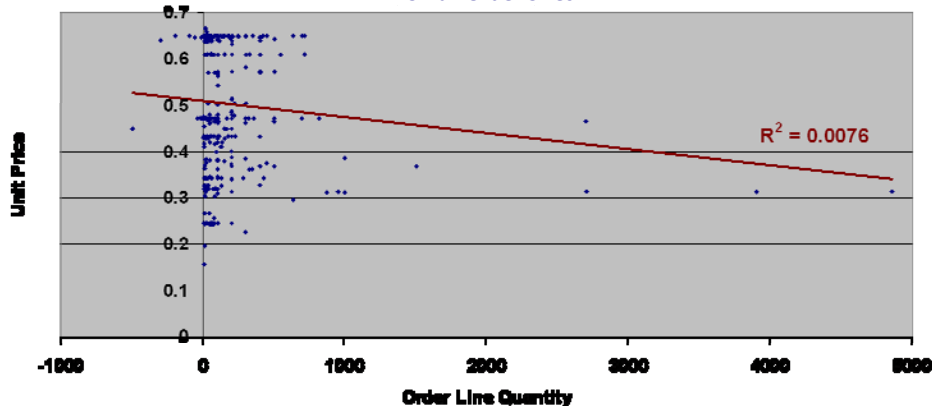
- **Problem:** Rushed sales reps want to make a sale and move on- so the easiest path forward is to quote the Last Price Paid (LPP)
  - There is an assumption that the LPP was correct and worse, it is the path of least resistance
  - They mistakenly assume that the customer remembers LPP even on tertiary items
- **Solution:** Create a monthly report that ranks all sales reps by percentage of line items sold at LPP
  - Even raising price a penny moves it out of the category
  - You have many situations where you are several price increases behind the market

Let 5 wet monkeys show you the way  
[http://www.youtube.com/watch?v=0\\_u8sF1sW4A](http://www.youtube.com/watch?v=0_u8sF1sW4A)



## Analytics: Pricing Patterns

Slide 1 of 3- Same SKU  
Small Order Sizes

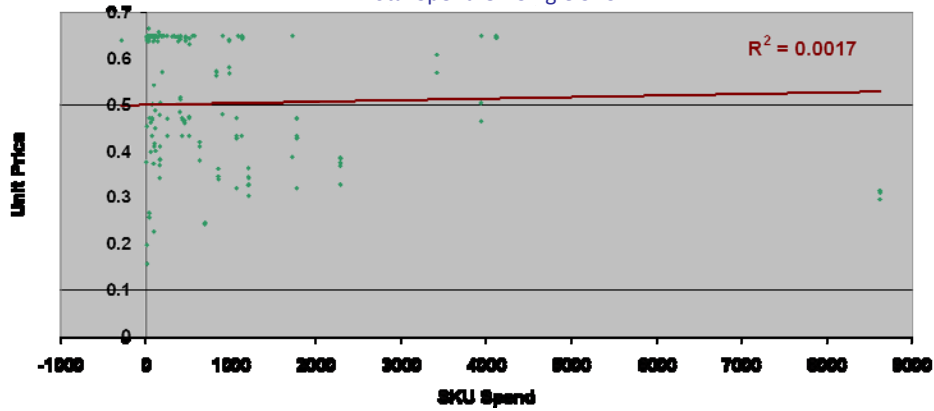


Notice that selling price declines with order size as expected. Big customers tend to both know the market and buy at the market. The variation is always with the smaller customers.



## Analytics: Pricing Patterns

Slide 2 of 3- Same SKU  
Total Spend On Single SKU

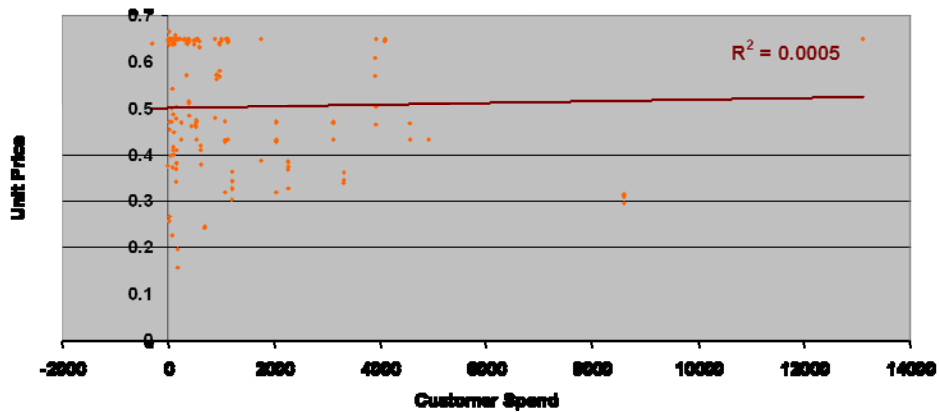


This is the long term cost of LPP. Notice the customers on the left (small total SKU spend) that are getting better than market pricing (below the regression line)



## Analytics: Pricing Patterns

Slide 3 of 3- Same SKU



These patterns of pricing as based on legacy decisions and they are important but not urgent. Distributors are good at doing urgent things.



## Key Mistake Number Three

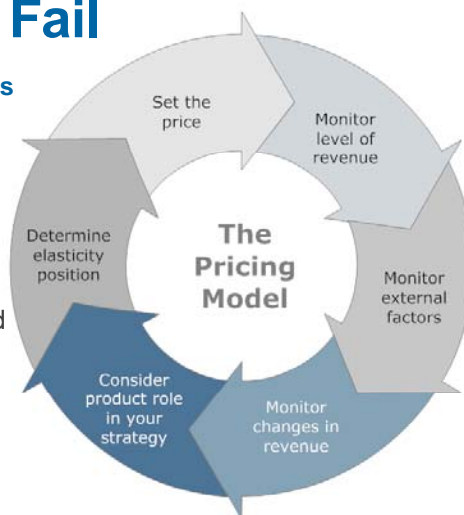
- You do not have a rules-based pricing process
  - If you need a process and don't get it, you will pay the cost of getting it with lower margins, forever
- The industry is event driven by opportunity and circumstance
  - It is made up of a series of emotionally charged data free discussions
  - Distributors use a "sharp pencil" to capture initial business with a new customer
  - Manufacturers use their "sharp pencil" to get incremental business that improves plant utilization
  - Both plan, or hope, to make it up "down the road"
- Neither have feedback loops to go back and measure results after the fact



## Analytics Without Process Will Fail

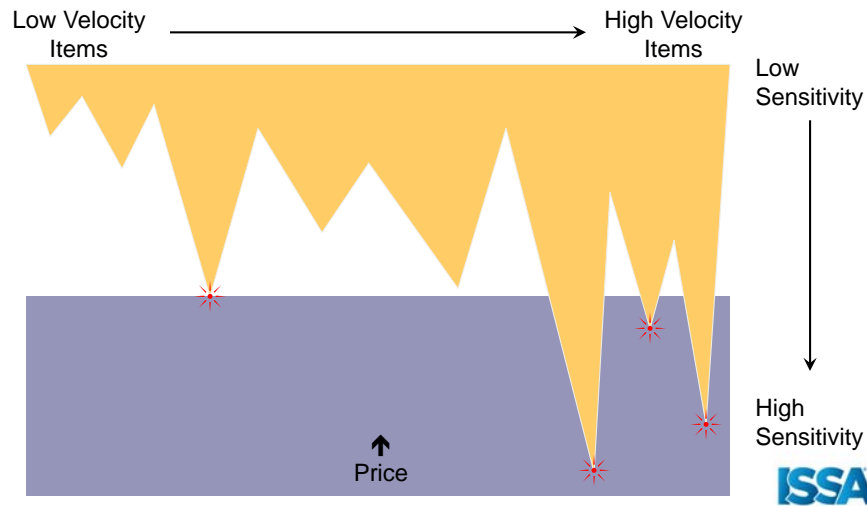
**It is never done as it is a process and not an event**

- The art is the evolving customer segmentation, product grouping classifications, life cycle positions, bundling effects, and velocity
- Each of these factors interacts with the others
- If you've seen one good process, you've seen one



## Finding Nooks and Crannies

Poking your buddy with a pin through his jacket



Advancing Clean. Driving Innovation.

13

## Changing The Rules

- The basis for any pricing strategy is customer segmentation
- Elasticity is the measure of how much volume changes with a change in price
  - High elasticity means large volume swings with small changes in price
  - Low elasticity means small to no volume swings with small changes in price
- Margin goes up to the extent that
  - The customer is irrelevant to the core business
  - The product is tertiary\* to the specific customer
  - The product is slow moving (infrequent demand)
- Margin goes down with the inverse of the above
  - Or single transaction size increases

\* The 80% of products that make up 20% of purchases

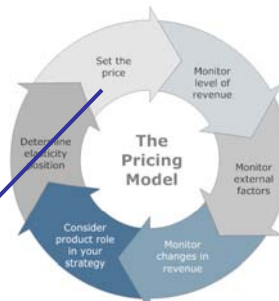
ISSA

Advancing Clean. Driving Innovation.

14

## Simple Size Example

Take Average Selling Price (ASP) for each SKU for each Customer Class\* (with a spreadsheet for each class) and change the ASPs by factors in the table. There is some art to this.



Customer Class Importance	Primary Product	Tertiary Product	Overall Slow Moving
Small	No Change	+20%	Add 8%
Medium	No change	+15%	Add 6%
Large	-1%	+10%	Add 4%
Huge	-2%	+5%	Add 2%
Growth Target	Temporary -2%	Temporary 0%	Temporary 0%

\*In a marketing world these would be targeted segments based on both potential to grow and cost to grow- not size categories



## A Simple, But Dangerous, Segmentation Example

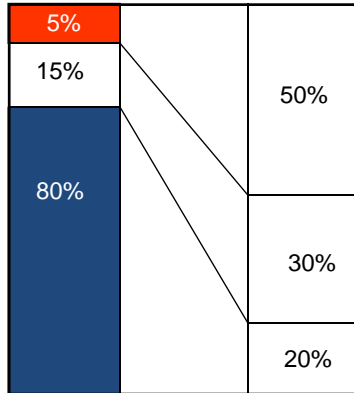
This works really well if you are understaffed for your current business mix and important things are falling through the cracks due to work load

*The right way to segment customers is by how they want to buy, then target them based on potential to grow and cost to grow*



# Customer Analysis

## Segments



# Customers

GP \$ Share

## Strategies

- Long Term Defense
- Customized Service
- Increase Penetration

- Retention
- Selective Optimization
- Increase Penetration

- Increase Profit
- Reduce free services



# Pricing Enhancements

Put them in and then give back to large customers

## Set Minimum Prices

- Order Size
- Cheapest SKU
- Invoice Handling Charge
- Delivery Fee

## Special Order Pricing

<u>Order Value</u>	<u>Gross Profit</u>
0 - \$100	\$30 + 50% GP
\$100 - \$500	\$30 + 40% GP
\$500 - \$1000	\$30 + 40% GP
\$1000 Plus	\$30 + 25% GP

## Restocking Fees

- Separate Stock From Non-stock
- Go with % or fixed dollars (i.e. \$25)
- Exempt Counter Current A/R  
(Provide Instant Credit)

## Miscellaneous

- Off Hours Opening Fee
- Quote Preparation Fee
- Don't Be A Terms "Woos"
- Move Matrices Up One Column Secretly
- Round Up Instead Of Down



## How To Make Enhancements Stick

- How large in quarterly volume is your smallest customer in the group that gives you 80% of your sales volume?
- Develop your enhancements
- Send a letter to all of your customers
  - Proud of new enhancements
  - Big guys have been carrying small guys
  - Not anymore, so pricing will be better
  - You're a big guy (\$1000 / Qtr.) and exempt
- Create a rising star category for sales reps (5/each) to exempt

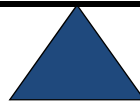


## Prime Account Programs

*Increasing your share of spend in a critical customer*

Customer

Distributor



Contract

- Bid On 100% Requirements
- Quarterly Review
- "Last Look" Review
- Premium Service
- Streamlined Administration
- Volume Purchase Agreement

*What premium service means.....*

Execs Home Phones

Employee Name Test

Gold Stickers

FIFO Exceptions

Bonded Stock

Multiple Relationships



## Volume Purchase Agreement The Annual VPA

<u>Annual Purchase Volume</u>	<u>Annual Discount</u>
Prior Year Volume (PYV)	0%
101% To 110%	1.0%
111% To 120%	1.5%
121% To 130%	2.0%
131% To 140%	2.5%
141% To 150%	3.0%
151% And Over	3.5%

There Is No Change In Ongoing Bidding Practices

- Resets At PYV Every Year
- Can Be Worked Quarterly
- Merchandise Credit Or Cash



## Action Plan

1. Get sales reps out of the pricing business
  - o At least measure their pricing realization or limit their authority to major quotes on target customers
2. Get a clean product file and limit who can write to it
3. Put someone in charge of gross margin (Czar)
4. Do some real MBA level analytics (get a guy)
5. Develop a process to raise prices back to market on small customers that have your best pricing
6. Start tracking LPP performance
7. Review customer pricing for changes doing a block of many each month (start with the small ones)
8. Attend the University of Industrial Distribution At Purdue (ISSA is a major sponsor)

