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mdm white paper

Optimize Online Pricing

How Distributors Can Build an Integrated and Agile Pricing Strategy

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When attempting to build an online pricing playbook, distributors often run into a series of roadblocks that can feel overwhelming to navigate. Online and offline prices that are in conflict. An established pricing plan that gets blown up by deep discounting throughout the year. Optimized prices for thousands — perhaps millions — of products with an equally large number of customers across many different channels. These are just some of the obstacles distributors face.

However, taking the time to work through these challenges will not only ensure the best price online to maximize profits and grow sales, but also give distributors a strategic understanding of how much money they've been leaving on the table through inefficient practices.

Through the lens of a mid- to large-size multi-channel distributor, this whitepaper will address pricing as it relates to five key areas:

1. **Time** — Reevaluate the sense of urgency you have for pricing activities. Have a long-term plan.
2. **Measure and Test** — Challenge all previous assumptions by constantly testing. Make it a part of the DNA of the organization.
3. **People** — Understand who you're working with. Do not underestimate the cultural hurdles you'll face in reforming your strategy.
4. **Information** — Know that information is power. The more data you have, the better you can establish optimal prices.
5. **Price Point** — Reconsider how many price points you really need. Technology can provide pinpoint accuracy, if done well.

Understanding these components and how they fit into the overall picture of your price strategy across all channels will be critical for distributors to succeed into the future.

1. Time

Before the rising dominance of e-commerce, distributors generally enjoyed success using a multi-channel strategy for sales representatives, branches, call-in centers and catalogs. While establishing a price in this environment was hard, it was often done annually and there was always plenty of wiggle room to account for possible cost increases from suppliers, inflation, competitive pressure, etc.

More than likely, you have inherited this approach to pricing. However, as more business moves online, you have found (or soon will find) this method is holding you back both online and offline. The speed at which the digital world is moving will require you to radically reconsider your own sense of urgency. For example, reports show that Amazon, on average, is changing sell prices nearly every 10 minutes. Moving your mindset from one-year increments to mere minutes requires a radical shift.

Think about pricing holistically over a long period of time. Online pricing makes it easy, perhaps even tempting, to make tactical changes. When done well, pricing should be a strategic competitive advantage. But be careful. Customers notice when you take advantage of a situation, such as a natural disaster, or artificially raise prices at the end of your quarter to hit a short-term financial goal. Social media and web comparison tools can instantly identify these actions. The immense damage you do to your brand in undertaking them is not worth it. A price project may get you an immediate lift in margin, but could also result in much longer negative economic impact on the company that might not be recognized until it is too late.

Example of Possible Impact of Short-Term Price Increases

Period	1	2	3	4	5	6
Total Units Sold	1000	1000	990	980	970	961
Sell Price per Unit	$200	$204	$200	$200	$200	$200
Cost per Unit	$150	$150	$150	$150	$150	$150
Gross Profit	$50,000	$54,000	$49,500	$49,005	$48,515	$48,030
Gross Margin	25.0%	26.5%	25.0%	25.0%	25.0%	25.0%

One-time benefit from temporariliy raising prices by 2% drops directly to Gross Profit

However, if this action resulted in a 1% drop in sales moving forward, your gross margins may appear fine, the reality is your Gross Profit dollars are decreasing

2. Measure and Test

Many distributors, intentionally or not, take the position that they cannot influence the sell price: "We sell the exact same item from the exact same manufacturer. We need to keep our price the same as our competition." This same line of reasoning is also present when you hear, "The sales people are the closest to the customer. They know what price it will take to win the business."

Have you ever considered testing these assumptions? In fact, best practices today allow for frequent measuring and testing of nearly everything online — including price. One of the easiest ways to see if a price is appropriately set is to do an A/B test. Serve some customers price A and other customers price B online. The results will speak for themselves after dozens, hundreds or thousands of customers either purchased or did not. All things being equal, the price was the one variable that made the difference.

It's true that many distributors are selling the same products. However, not all distributors offer the same value. Can your organization deliver in bulk? Do you have a great warranty or return policy? Do you offer installation or after-purchase support? Customers value these extra services and are often willing to pay more for them. Your job is to figure out which ones they value and by how much. You do this by testing and measuring. In this case, you can survey your customers and measure their responses. Say you get a large percentage of customers telling you that they appreciate your after-purchase support, it would be wise to at least cover your cost for this service and perhaps advertise it.

The notion that sales people are closest to the customer and therefore know best may have been true in the past, but the internet makes available far more customers in one hour than a sales representative can see in a week — perhaps several weeks. These online customers are giving you real-time, valuable information based on their actions — without the filter or bias of a human. Once again, all you need to do to make this valuable information actionable is to measure and test.

You will need to make "measure and test" a part of your company's DNA. Leaders are always asking, "Where is the hard data?" You can still balance anecdotal evidence in your decision making, but you should weigh the experience of one or two sales representatives appropriately against the actions of thousands of customers online.

That said, allow for a culture that can fail and then act fast to adjust. Measuring and testing, by definition, will expose many things that are not working well. For example, when you learn a new item was priced too low, applaud your team's ability to make adjustments instantly rather than be angry that someone made an initial mistake.

Never before have you had the ability to learn from as many customers so quickly without any bias. Leverage this opportunity and you will not only set optimal prices online, but you will also significantly grow your business.

3. People

The way you approach your people goes far deeper than typical change management techniques. When implementing optimized pricing, the core of your culture will be exposed — and will need to change. In fact, Jonathan Bein, managing partner at Real Results Marketing, says, "The No. 1 reason for success, or otherwise, when it comes to price optimization efforts is the cultural hurdles that must be met."

> Be transparent with your staff. Be available. Understand that during the period of change they will be looking at you for leadership, coaching and encouragement.

Many successful companies have managed to move away from the "growth at any cost" plan and have implemented a "profitable growth" plan. However, at many distributors, sales representatives have a tremendous amount of influence over the final sale price — particularly at large accounts. Often, they are are incented for only topline growth. To adjust to a profitable growth plan, sales people need to be trained to sell value and adjusted incentives that allow for profitability in each transaction.

Don't stop there. With more business moving online, sales representatives will need to continually evolve. Their role will move into a relationship-building function. Rather than focus exclusively on the next transaction, they will need to learn to grow their share of the wallet within their assigned accounts. The incentive would be targeted at overall account growth and profitability — not each transaction.

Additionally, the common perception of pricing as a necessary evil creates an environment where most distributors do not have any one person in charge of it. The annual approach to adjusting prices usually makes the effort into a short-term project. Instead, a single person must be accountable for the strategy, logic and required cross-functional communication for pricing.

Ideally, this person would have a product management role, with a direct line of communication to executives. One person charged with knowing the true cost of items will allow for a better judgment call between gross margin percentage and revenue. It is helpful to have this person meet with customers frequently.

Trying to house the pricing effort in the finance or accounting departments can make the policies too rigid. However, making it a sales department function can also lead to overly flexible policies. The person running the pricing function will need to be an expert at cross-functional communication in order to succeed.

4. Information

Traditional distributors use a variety of price strategies — cost plus, good/better/best, price matching, value based, etc. — and often implement them based on manufacturer input, a review of some competitors and perhaps comments from sales representatives. However, to truly optimize your sell price, you will need a great deal more information, and you need it faster. Imagine what price you could establish if you knew real-time inventory levels, true profitability of the transaction, alternative products, competitors' prices, buyers' perceived value, where your customer is in the buying journey, weather conditions, and much more.

It is true that you should not change your online prices to take advantage of a short-term situation, but your long-term strategic view can influence the frequency with which you change price based on gathered information. For example, you may have a strategic imperative that your company will never be beaten on price by Competitor X. Because you will be collecting information constantly, you will instantly know when Competitor X lowers their price. To stay true to your strategy, you lower your price. There will be many strategic reasons to constantly adjust your prices. Identify these reasons before they occur to avoid being seen as taking advantage of a short-term issue.

So how much data should you collect to make these decisions — and how should you go about doing it? Enter the world of big data. The now ubiquitous term refers to data so massive that only a powerful computer can process it in a timely fashion.

As such, there are price optimization tools on the market that can handle all the data collection for you. Some of these systems also have artificial intelligence components that not only make sense out of all the data, but can also learn and anticipate/predict outcomes. To leverage this technology, you will need to commit to collecting enormous amount of data. Note that Amazon, Walmart, Target and many other retailers use this technology daily. Distributors are just beginning to see the amazing possibilities and first-mover benefits that come with implementing this technology.

The adage, "information is power" is absolutely correct. The more data that is collected, the better decisions that can be made. Leveraging all this data will require AI.

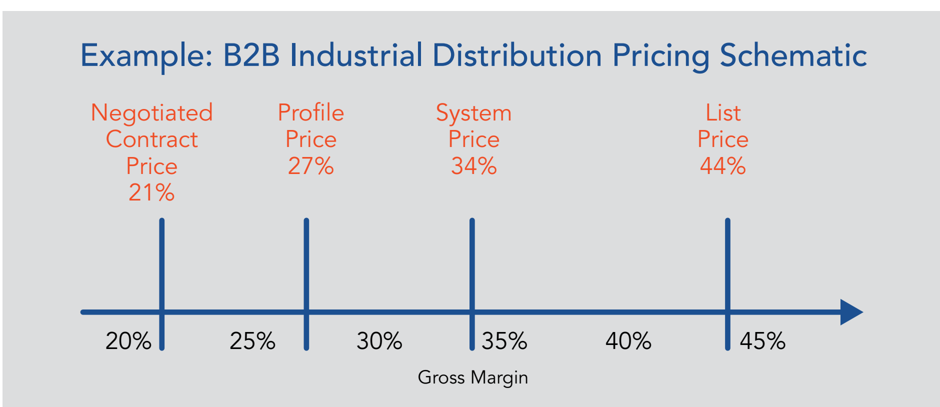
5. Price Points

Historically, distributors believed that the price that was listed in the catalog needed to match what was sold in the store. Ideally, that same price would be used, at least as a starting point, for sales people to begin their negotiation. In other words, items were all priced (more or less) about the same for each of the channels. The logic behind this being that customers expect a consistent experience regardless of channel.

When you move your mindset from a "consistent" to "genuine" customer experience, this will free you up from having to think the price must be the same. Differentiated prices along channels, segments (such as half-price for children) or other reasonable causes (discounted bread at the end of the day) are all long-accepted price practices customers understand.

Customers also show a wiliness to pay slightly more for items in your store because they can see it, touch it, smell it and, perhaps most importantly, they can take it with them immediately. Price optimization across channels to reflect the value the channels bring and their unique cost structure is reasonable. However, if the only reason you have a different price in certain channels is to maximize company profits, then you may want to re-think your entire price strategy.

Equally problematic are classical pricing schematics of distributors. Most distributors have multiple price points to serve different types of customers. The "list price" is supplied by the manufacturer. It is rarely used for anything other than negotiating a discount or presenting a price to a good customer to show how much you are discounting their price. The "system price" uses limited/historical data and is intended for infrequent customers. The "profile price" is set up by pricing leadership as a floor rate for frequent buying small- and medium-size customers. Finally, the "negotiated/contract price" is the result of many individual face-to-face interactions with sales reps and customers.



Unfortunately, being online exposes two major unintended consequences of this classic approach to distributor pricing. First, it relies on smaller customers subsidizing margin for larger accounts. Second, it can make the list and system price appear out of line with the rest of the market. The latter issue occurs when customers go online to review prices. If you establish your prices too high, the result is that you are not even considered in the customer's buying options. If you set the price too low, you risk upsetting established customers with pre-negotiated prices.

Resolve these issues by gathering and using as much information as possible for the products and customers. Use big data and AI as a guide to differentiate pricing. At the very least, the product data will include prices from many competitors, price sensitivity as it relates to demand and historical results. As your system gets more sophisticated, you will also want to add data such as inventory, seasonality, substitute products, etc., as well as a factor based on your understanding of how your customers react to different prices in different channels. By starting out small, then actively measuring and testing, your big data and AI will determine and serve up pricing boundaries. This will go a long way toward optimizing your prices across channels.

Remember, retailers have already been using optimized pricing tools. Some have taken the next step and combined personalization with optimized pricing. Personalization is a big data and AI technique that identifies a person coming to your website, instantly analyzes why the customer is there, identifies where the customer is in the buying cycle and then serves them the most customized reply for their situation.

For example, using personalization tools, you will know the name of the person coming to your site. You will also know that they just came from one of your competitor's sites. You can detect by the key words they use to search and other factors what phase of the buying cycle they fall into. At this point, you can serve up prices that fit your rules regarding the size of the customer, location and a wide variety of other issues that impact your price strategy. You can also go further than traditional pricing and offer up cross-sell/up-sell opportunities.

While preparing to implement a powerful pricing tool, consider the value of even having a list price. A number of distributors long ago stopped using list prices. Additionally, look at your system price. You will need to do the math that shows how many new orders and customers are gained with different price points. Setting this price too high will guarantee that you will eliminate the prospect of new customers coming to you. Setting it too low could negatively impact gross margins and bring you disloyal customers who will switch at the next lower price.

Real Results Marketing's Bein states, "It will take time for the distribution market to catch up to retail in technology. In the meantime, many distributors are finding a sweet spot to list their prices online without fear of rejection or fear of lost profits." You can join them.

Summary

It is difficult to optimize your price online while taking into consideration all of the other channels distributors manage. You can use the same technology retailers use to manage prices, but to be successful be sure to address your culture first. Know your sense of urgency and how well you and your staff can adjust from relying on intuition and one-off encounters to measuring and testing all assumptions. Help your people evolve in new roles and expectations, and then define your price strategy. By starting this price optimization journey now, with the right big data and AI technology, you can develop a true competitive advantage in distribution that, over time, will only become harder for others to emulate.

About Zilliant

Zilliant is the world's leading provider of AI-enriched SaaS solutions that maximize the lifetime value of B2B customer relationships.

Zilliant helps companies increase profitable growth by applying predictive intelligence to your customer and transaction data, so you always know what to sell, to whom, when and for what price.

Zilliant uses advanced AI, machine learning and sophisticated predictive models to deliver customized, actionable guidance to your team in real-time through your existing platforms. With Zilliant you can achieve profitable growth, increase competitive advantage, reduce business complexity and successfully implement business transformation, so you can maximize the lifetime value of every customer.

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