WHY BAD PRICING HAPPENS TO GOOD COMPANIES

A look at how poor pricing practices expose one manufacturer to unnecessary risks

INSIGHT2PROFIT

Gordon McGrath knows he has a problem on his hands. He's just been hired as the CFO at Luxentra, a global manufacturer of electrical wiring and lighting controls. On the surface, the company appears to be in excellent condition. Luxentra is a leader in its industry with outstanding products and strong sales. The company has also recently undergone an aggressive cost cutting campaign, which improved both cash flow and profitability. But after digging deeper, Gordon sees some red flags that have him worried:

- Luxentra manages thousands of SKUs but lacks a central methodology for establishing pricing and profitability standards across its large portfolio.
- The sales staff has direct control over pricing, with near unlimited authority to offer discounts to customers.
- Average pricing per product has declined for several years.
- New foreign competitors and new supply chain pressures are looming, potentially threatening the performance gains Luxentra has worked so hard to achieve.

It's a sobering reality, but Gordon knows strong sales and smart cost cutting will only get Luxentra so far.

PRICING PAYS OFF

A well strategized, well executed pricing improvement program can deliver significant returns without compromising sales volume.

12.3%

Average increase in operating profits when price increases by 1% without losing volume.

200%-350%

Average ROI from a pricing improvement program in the first 12 months alone.

Without a comprehensive pricing strategy that properly positions Luxentra in the marketplace and communicates Luxentra's real value to customers, the company will never achieve its full potential for growth and profitability.

From past experience with successful pricing initiatives at his former company, Gordon knows even small improvements in pricing strategy can translate into significant increases in value – setting Luxentra up for years of growth.

From Gordon's perspective, it's time for Luxentra to shift strategies and turn to a strategic pricing management program. But before he can implement changes, he needs to evaluate where the company's pricing problems originate.

Bad Pricing Practice #1:
Price Leaks

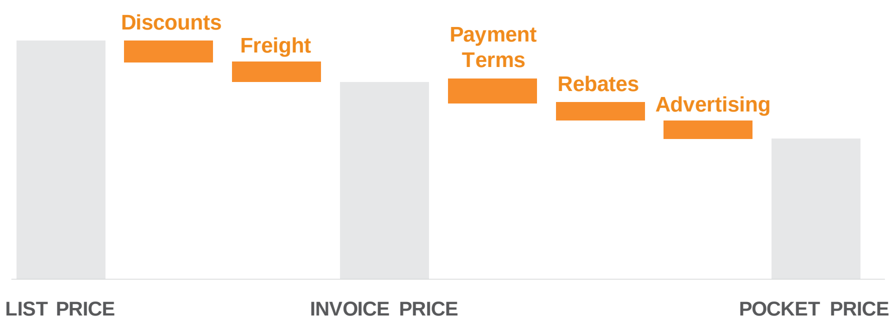
THE PROBLEM:

At Luxentra—just like at most B2B companies—the stated list price never actually ends up in the company's pocket. Luxentra offers its customers a variety of additional price reductions on and off the invoice that reduce the true price the customer pays. These discounts range from volume discounts to channel discounts to freight rebates, co-op dollars and payment term discounts. Each one of these additional concessions drains profitability from Luxentra's sales and leads to price leakage.

THE SOLUTION:

In order to fix price leaks and develop a program that positions Luxentra for optimal profit, margins and customer net pricing need to be aligned. A data-driven strategy that identifies, quantifies and prioritizes opportunities for pricing improvements will provide Luxentra with the foundation it needs for positive changes.

SYSTEMATICALLY IDENTIFY AND QUANTIFY SIGNIFICANT PRICE AND MARGIN WATERFALL ELEMENTS



COMMON PRICE LEAK AREAS

- Pricing
- Freight
- Discounting
- Collections
- Samples
- Returns
- Data Systems

Bad Pricing Practice #2:
Lack of Value Pricing

THE PROBLEM:

Pricing decisions are typically made based on a variety of factors, including cost basis and competitive price factors. However, the company lacks a complete understanding of its customers' perceptions, such as why customers buy from them, which product attributes customers are willing to pay more for and even how to position Luxentra products from a value perspective.

As a result, when a premium price is established for high-end products, it's often not sustainable over time. Without a cohesive strategy for establishing value pricing and communicating that pricing to both the sales teams and customers, Luxentra is too often forced to compete on price rather than competitive advantage.

THE SOLUTION:

Aligning value with price will allow Luxentra to operate more efficiently in its evolving marketplace. This process starts with data mining, including external market research, regional and global pricing influences, and internal pricing resources. As Luxentra transitions into a value pricing organization, the company will be able to identify opportunities with higher sustainable profitability, establish price targets, and begin to communicate real value to its customers.

Bad Pricing Practice #3:
Poor Price Change Management

THE PROBLEM:

Despite Luxentra's successful cost management program, industry experts project energy and transportation costs will rise in the coming year – developments largely outside the control of Luxentra. However, any attempts to increase prices to accommodate these new market conditions have been applied only tentatively and sporadically. The company lacks a methodical, consistent process for determining price adjustments and communicating those changes across customer segments.

Additionally, although the company makes robust investments in new product development, these new products are often priced just a few points higher than existing products due to fear of customer backlash. At the same time, prices on older products are often lowered in order to move that inventory.

With this reactive approach to pricing, Luxentra is diluting its market leadership position and rapidly transforming itself into an average performer

THE SOLUTION:

A proactive price change management program will allow Luxentra to focus on strategic, life-cycle pricing that incorporates actual costs and optimal profitability across all product and customer segments. As Luxentra establishes an analytical framework for analyzing the potential impact of pricing increases, the company will be able to make data-driven decisions, forecast future price changes, and adopt a long-term price leadership position in the market.

Bad Pricing Practice #4:
Poor Quoting Process Management

THE PROBLEM:

When providing quotes to customers, the sales reps often follow their gut intuition. They might consider the size of the account and the size of the sale, or they might consider how forcefully the customer negotiates. They may also look at the discount they offered the customer last month and find it tempting to simply offer the same discount on the new order. Decisions are made on an ad hoc basis, without any established process or methodology for assessing customer relationships, product positioning, and pricing opportunities.

This results in significant price variance, wherein some customers end up paying significantly less than others. Profit margins vary widely by customer, by product and by sales channel, leaving millions of dollars in potential profit on the table.

THE SOLUTION:

Luxentra needs a pricing segmentation strategy that incorporates actual data at both the micro-level (such as product profit margins and customer sales spend) and the macro-level (such as customer demand and the overall competitive environment). By differentiating pricing according to segment, the company can identify the most price-sensitive customers, target the most profitable customers, and position products for maximum profitability. Then, this pricing strategy should be embedded in a quoting application or other tailored software solution such that sales reps and leadership can manage outbound quotes against the pricing strategy and profitability goals.

PRICE QUOTING BY KEY VALUE DRIVERS

CUSTOMER
- Channel
- Market
- Size

PRODUCT
- Life Cycle
- Grade/Quality
- Competitiveness

ORDER
- Order Size
- Lead Time
- Packaging

Bad Pricing Practice #5:
Poor Pricing Systems Infrastructure

THE PROBLEM:

Luxentra's transactional data is spread out over multiple systems, consisting of Excel spreadsheets, ERP, and BI systems. Every time a trend needs to be explained to the board, Luxentra's analysts need to sift through overwhelming amounts of information to find the nugget of data that sheds light on the problem.

Even more problematic, Luxentra's current systems aren't set up to offer alerts to offset issues before they arise. When a major change occurs, or when prices aren't being realized, there are no systems in place to head off profit-eroding trends before they impact the bottom line.

THE SOLUTION:

Luxentra needs a pricing business application that makes intelligent use of its pricing data. Such a tool would offer robust and tailored scorecards, dashboards, and alerts to transform inbound data into actionable information. With a system like this in place, Luxentra's analysts would have more time to think critically about the pricing strategy and offer the company powerful, game-changing insights.

Conclusion

As Gordon looks at all aspects of Luxentra's pricing strategy, he's identified many areas for improvement. Some are low-hanging fruit, while others are more challenging and will take time to implement. But Gordon isn't deterred. He knows better visibility in pricing will lead to better business decisions that will improve profitability, leverage efficiencies, and solidify Luxentra's position as a market leader.

Maximize Success with a Proven Pricing Partner

INSIGHT2PROFIT can help you fine-tune your pricing strategy and software solutions, and then implement effective change throughout your organization. We lead the pricing industry with customized, data-driven solutions that minimize risk and maximize returns. Armed with our proven expertise and proprietary software, we help you measure, analyze, set, and execute pricing that enables sustainable profit gains and increases your business value.

Not sure where to start? We'll help you find a solution that's right for your company.
Contact us at www.insight2profit.com for a free consultation.

INSIGHT2PROFIT is headquartered in Cleveland, OH with regional offices in Chicago and Columbus. INSIGHT employs more than 250 professionals and has appeared on the Inc. 5000 fastest-growing companies list in America for ten consecutive years. INSIGHT2PROFIT delivers tangible results by developing and implementing data-driven pricing strategies and tailored software solutions to help clients achieve continuous profit improvement.

For more information about how INSIGHT2PROFIT can answer your questions about pricing, visit: www.insight2profit.com