CREATING A COORDINATED PRICING EFFORT

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THE DISTRIBUTION TEAM

Pricing products is one of the most sensitive activities in most distribution organizations. Many companies find themselves leaning toward convenience versus maximization when they set up pricing strategies. By choosing convenience, organizations leave a significant amount of gross margin dollars on the table. By taking a strategic, coordinated approach to end user pricing, distributors can significantly improve margins and ultimately drive net profit. In order to realize this return, you have to make an investment.

Investing in a pricing coordinator is one of the best moves I made during my distribution career. After attending a seminar in 2002, one that I now teach, I took away the concept of a pricing matrix guru. From a technology utilization perspective, most distributors use less than 15% of the capability of their distribution software package. In order to pour a little salt in the wound, we are often reminded what percentage of that package we paid for. The math doesn't work in our favor. One of the most underutilized features of any distribution software package is the pricing matrix. Sure, we dabble in the functionality and get the basics down. Sadly, this is where most companies stop. They fail to unleash the power of a strategic pricing matrix.

After coming to this realization back in the early 2000s, I recommended that we invest in a person dedicated to the coordination and maximization of pricing products. Not only would this person be charged with mastering the matrix functionality, but they would learn the principles of strategic price increases and margin improvement. In about 12 months, through the hard work of this person and several others, we realized a 2 percent increase in our average gross margin. This was more than enough to justify the existence of the position.

As I mentioned earlier, most distributors take a convenient approach to creating a pricing matrix. They limit the number of customer types to 4 or 5. Sometimes these are called tiers. Often they are based on volume or potential. Regardless, the method generally lacks any strategic thought. This is really short sighted. Even if you generally serve one type of end user, could they be broken down into subsections? I worked with a pool supply distributor a few years ago. On the first blush, one would suggest that they served a limited customer type. Upon closer examination, they sold to service contractors, residential and commercial builders, masons and retail dealers. There were several opportunities for segmentation in their customer mix. At least we could do better than: A, B, C and resale.

The real powerful segmentation comes on the product side of the matrix. Again, I have found a significant amount of lazy thought in most pricing schemes. How many of us have created a flat discount, or mark up, across a vendor line for the same customer type? All "Level 3" customers get 25 percent off list on Superior Brand widgets. This is very common. In fact when I teach this subject, several participants tend to grin and look at the floor. It happens. We were really stressed out when we set up the system and opted for a quick approach to pricing. Here is the problem – that was seven years ago. It's time to update our thinking.

If we look at an entire line of products, some are going to be really hot sellers and others are there to complete the offering. Ask yourself this question: What percentage of a line do your customers really know what they should be paying? The really popular items fly off the shelves and enjoy significant turns. Unfortunately, these items generally account for less than 10 percent of the SKUs in the entire line of stocked products. The remaining 90 percent live on your shelves and accumulate carrying cost. If we really want to make some money, we need to establish pricing based on the popularity of the item. This is sometimes referred to as sensitivity based pricing.

Train your new pricing matrix guru to study product movement. With guidance from sales management, the pricing matrix should allow for competitive margins on highly popular items and significant increases on slower moving product. Over time, maintenance of this scheme will require less and less management oversight. A good pricing matrix should handle 85% of your transactions.

Beyond the manipulation and maintenance of the matrix, the coordinator should be responsible for updating all incoming price increases from our suppliers. As you all know, this is no small task. I have seen more than one distributor fall behind on this procedure. When proper costs are not maintained in the system, net profit challenges occur. Purchase orders go out with the wrong pricing. This causes additional work for the payables team to straighten out. Sales people use outdated costs to generate quotes.

If we do run sales through a matrix, margins will be diminished until we update the basis for pricing.

By delegating the responsibility of price updating to a central coordinator, that person can focus on the most efficient way to get the data into our system. Many distributors resort to manual keying of updates because they have not become familiar with the importing features built into most packages. It will be critical for our coordinator to drive the most efficient solution and create a standard procedure for updates.

In order to get a solid return on the investment, some companies have chosen to give the coordinator additional areas to manage. One of the most challenging tasks, with regard to pricing and costing, is the Special Pricing Agreement or SPA. While this practice is most common in the electrical distribution world, it can be found in many different vertical markets. For those of you who have not been exposed to this practice, I will give a brief overview.

There are a couple of different methods, but the most common is where the manufacturer extends a special price on items to a specific customer. Some agreements allow the distributor to replenish inventory sold to the specific customer at the discounted price. The more common method is for the distributor to buy inventory at the regular pricing structure and apply for a credit from the manufacturer when the contract items are sold to the specific customer. I have run across situations where distributors sell product below their cost and wait for the manufacturer to make them whole again. Unfortunately, some manufacturers are slow with the credit process. Because the process can be so cumbersome, credits due are not always realized by the distributor. A point person, like a pricing coordinator, could get their arms around the process and make sure that these agreements are managed properly.

Along a similar vein, managing rebates from manufacturers can be a challenge. The devil is in the details. In most situations, this can be solved with reporting. On the other hand, wouldn't you rather have someone making sure that the company receives all the monies they are entitled to? I am not suggesting any nefarious activity on the part of suppliers, but mistakes occur. Since many companies rely on rebates to shore up their bottom line, it is incumbent upon the organization to invest in some form of oversight.

So where do you find the right candidate? I found mine in the purchasing team. This person had the right combination of technology interest, sales familiarity and diligence. One of my private clients suggested that someone with an economics background might be a good fit. Rather than just being adept with data analysis, economists look for patterns. They search for cause and effect. I couldn't agree more.

Let's face it, margin management is an ongoing struggle in a wholesale distributorship. We are forced to be better, stronger and faster than ever before. Technology and customer service don't come cheap. We need to do everything in our power to insure that we maximize gross profit so that we will have the opportunity to be of service in the future. A pricing guru is a great place to start. As always, I am here to help.