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Pricing in B2B2C Environment

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Introduction

Any manufacturer or distributor operating in a B2B2C environment is at least one step removed from the end customer. In this paper we will address the critical question: "**How do I influence the price to the end customer when I don't set the price?**" Specifically, we will cover the criteria for making pricing decisions that allow your channel partners (distributors, dealers, retailers) achieve their margin targets with price points that are commensurate with the value delivered. And show how you can use pricing and other incentives to encourage mutually beneficial outcomes for yourself and your channel.

Part 1: Why is it so hard?

Pricing (in general) is hard, and rarely done well. Throughout the pricing process, from initial list price-setting to the eager salesperson trying to win a deal, there are many opportunities for your pricing strategy to divert from your best intentions. In B2B2C businesses, complexity and diversity of portfolio (products, customers and channels) multiplies these pitfalls and too often derails pricing ambitions. In addition, pricing at the end-customer level is becoming more transparent than ever. From your distributors that are setting up shops on Amazon Business to your competitors that are setting up direct-to-customer sales channels or leveraging marketplaces, it is becoming critical that B2B2C companies develop effective pricing strategies. This is compounded by a prevailing industry belief that volume comes at the expense of margin, and vice versa.

In our experience, there is "good complexity" and "bad complexity." Good complexity in B2B2C can be a source of advantage that provides the opportunity for deliberate and surgical pricing strategies to drive margin AND volume growth simultaneously, achieving transformational commercial impact of 300-500 bps growth in EBITDA and increased market share[1].

Bad complexity, by contrast, is frequently the result of many ad hoc price exceptions, stacked on top of each other, that lead to highly variable pricing that is hard to explain to customers, difficult to track and invoice, and ultimately leads to margin leakages due to inappropriately applied discounts, invoicing disputes, and competitive reactions.

[1] Monitor Deloitte Analysis

What are the common pitfalls that companies succumb to?

We typically see B2B2C companies succumbing to five common pricing pitfalls:

1. Insufficient integration between pricing and broader strategic choices. For example, a premium industrial equipment manufacturer constantly competed on price at non-target customers against low-cost overseas manufacturers thereby diluting their brand positioning in the market. Your pricing must be connected with "where to play" and "how to win" choices.

2. Using pricing as a tactical lever to drive margin % OR volume on a quarter-by-quarter basis. Instead the focus should be on using strategic pricing to drive and sustainably grow total EBITDA dollars.

3. Using "one-size-fits-all" approach to pricing across a diverse customer base, which typically leads to sales teams resorting to ad hoc price discounts to meet the customer expectations. The better approach is to create segmented pricing through product / offer variants and price fences & metrics to align price with value, cost to serve and / or willingness to pay.

4. Static pricing strategies that are not updated to reflect evolving context and / or emerging customer needs and expectations. While it was difficult to imagine consumption-based pricing models for industrial equipment a few years ago, now there are multiple examples of equipment manufacturers operationalizing consumption-based metrics through IoT and other technologies.

5. Pricing is often a shared responsibility across Sales, Marketing, and Finance functions, with no clear accountability for building pricing into a cohesive strategic capability.

These pitfalls combined with the inherent complexity of pricing in the B2B2C context make it hard for companies to get the pricing right.

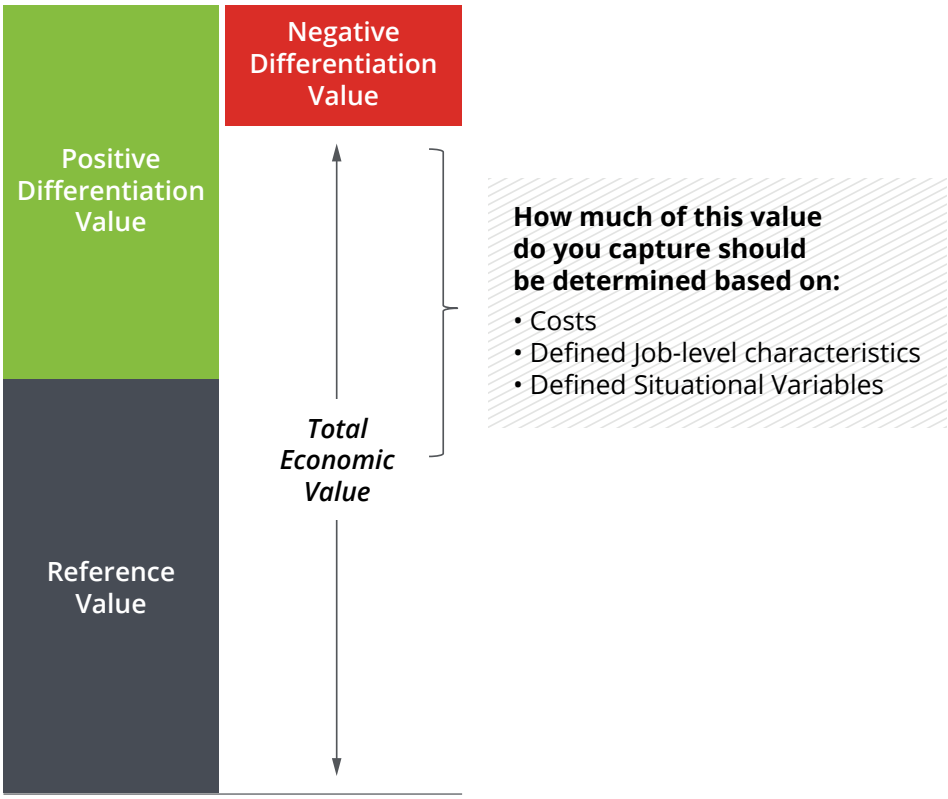
Part 2: How to go about it?

Pricing strategy should ideally be linked with the broader go-to-market strategy while allowing the company to serve customers with differing willingness/ability to pay, address trade-offs and avoid the common pricing pitfalls outlined above. An effective pricing strategy should be built on logic that optimizes pricing by product type, by customer type, and by channel; and does that in sync across the entire portfolio.

- **Product Pricing:** A winning pricing strategy begins with a robust product pricing approach that is anchored in differences in value delivered to customers. In addition, product pricing strategy should also consider differences in price sensitivity and available budgets – some products may be highly valuable to customers but due to the expense customers may still be likely to shop around and negotiate. For example, a customer buying a high cost machine is likely to get quotes from multiple vendors to ensure that they are getting a fair price. Yet customers are not always looking for the lowest price. In some cases, they simply want to understand the capabilities of alternatives and will pay a premium for quality. And in other cases, they are simply looking for basic functionality at the lowest cost. The environment and nature of your products should determine the appropriate pricing strategy.

  To understand the relative value of your offering, you need to assess three things: (i) price of your competitor; (ii) the points of differentiation via a vis your competitor and how these differences can help customers generate more revenue or reduce cost; and (iii) a clear-eyed view of how your competitor may do some things better than you. Netting out these three elements provides a quantified view of the economic value you deliver relative to a competitor. EVE® is a Deloitte-developed framework that formalizes the assessment of value.

Figure 1: Economic Value Estimation Framework®



In the industrials manufacturing context, we typically encounter three broad categories of products:

A. Stock Products:

i. Pricing for stock products should first consider product segmentation, whereby products are placed relative to others along variables that can be linked to value capture expectations (e.g., level of commoditization, complexity, application type etc.).

ii. Then for each product segment the most appropriate competitive reference point needs to be defined. In industrial manufacturing environment it's not always easy to determine the right competitive reference point. For less differentiated / commoditized products the reference could be derived from a premium brand, a value brand or a generic manufacturer. For differentiated / proprietary products it becomes even more challenging but, in those instances, a reference could come from within your own portfolio.

iii. Finally, the correct premium/discount relative to this reference must be determined. Highly commoditized products should be priced aggressively relative to competitive reference to take advantage of volume opportunities, whereas pricing strategy for more differentiated and proprietary products should allow you to capture value and expand margin.

Here is an example of a simplified product segmentation framework that was designed for a large industrial products manufacturer. In this example each part was segmented based on how differentiated it was compared to its competitors (product type) and how critical it was to the application – for e.g., a commercial air conditioning compressor is a lot more critical when installed in a hospital operating room vs. an office building (application type). A clear pricing approach was then defined for each of the combinations in the grid below that provided a structured framework to the sales teams when quoting these parts.

Figure 2: Illustrative Product Segmentation Framework for Stock Products

Application Type / Product Type	Critical Application		High Value Application		Low Value Application	
Proprietary	Higher Value, Higher Price Points					
Differentiated						
Commodity						Lower Value, Lower Price Points

For each of these combinations think about the right pricing logic i.e., reference and premium/discount relative to the reference

In this example, Value and price sensitivity is linked to product type and application

B. Configured to Order (CTO) products:

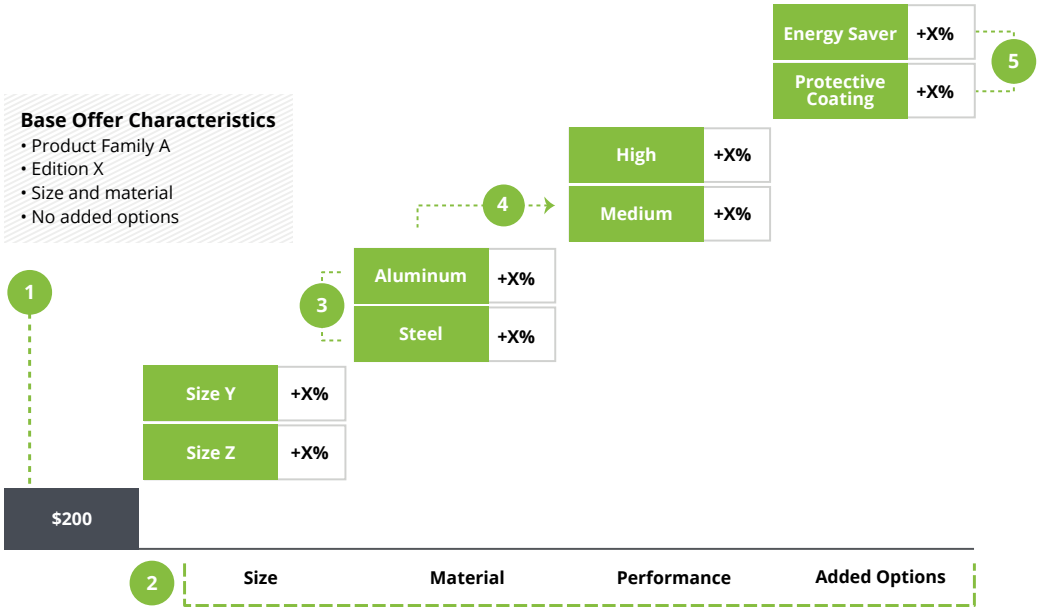
i. Pricing strategy for CTO products should first focus on establishing the right base product. We frequently see situations where a base product is either too built up to begin with or not appropriately defined at all, creating challenges with finding the right reference and / or being misaligned with customer needs.

ii. Once the base product is appropriately defined, it should be priced right relative to competition and relative to other product lines in the portfolio.

iii. This base product should then be subsequently combined with a menu of discretely priced options to create the CTO product based on customer needs. Like base price approach, the price of each option needs to consistently reflect real value differences relative to competitors and other options within your portfolio.

Here is a simplified example of "Adder-Ladder" pricing framework for a large US-based manufacturer. The Base Product defines the most common, "vanilla" configuration that can be sold to a customer. On top of the base product there are 4 adders that are clearly defined and have options that have been objectively evaluated to have prices based on what value they provide to the customer This Adder-Ladder framework provides an easy and objective mechanism for sales teams to price any configuration of the product and communicate that price to customers.

Figure 3: Illustrative CTO Product Pricing Framework ("Adder-Ladder")



1. **Basic product** within each product line
2. **Categories of "adders"** which go beyond the basic option
3. **Options within each adder** category
4. **Sequencing** of adders that have dependencies
5. **Price differences for each option** based on value, cost, and price sensitivity

C. Engineered-to-Order (ETO) Products:

i. Pricing for ETO products begins with ensuring that the offer has been structured in the right way to begin with i.e., you are not just providing one fully bundled (turnkey) solution to the customer. It's important to unbundle the solution and create optionality. Start with what the customer is asking for and offer certain options that would be value accretive to both you and the customer.

ii. Next, anchor the price of these options in value relative to reference and NOT based on cost-plus approach.

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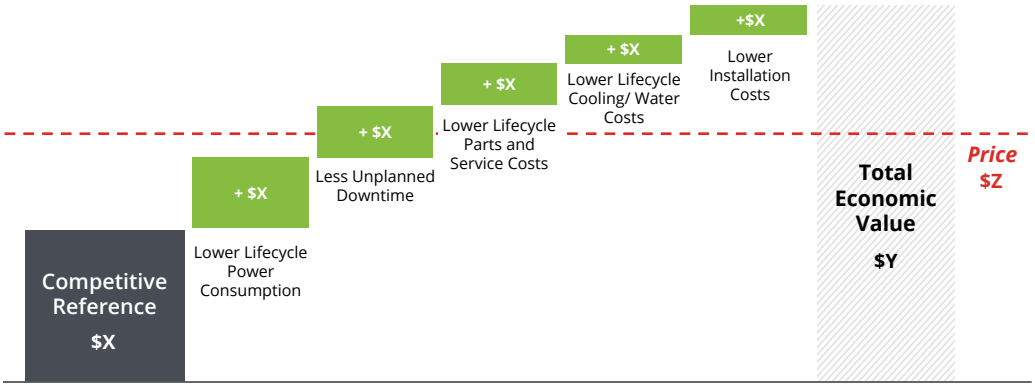


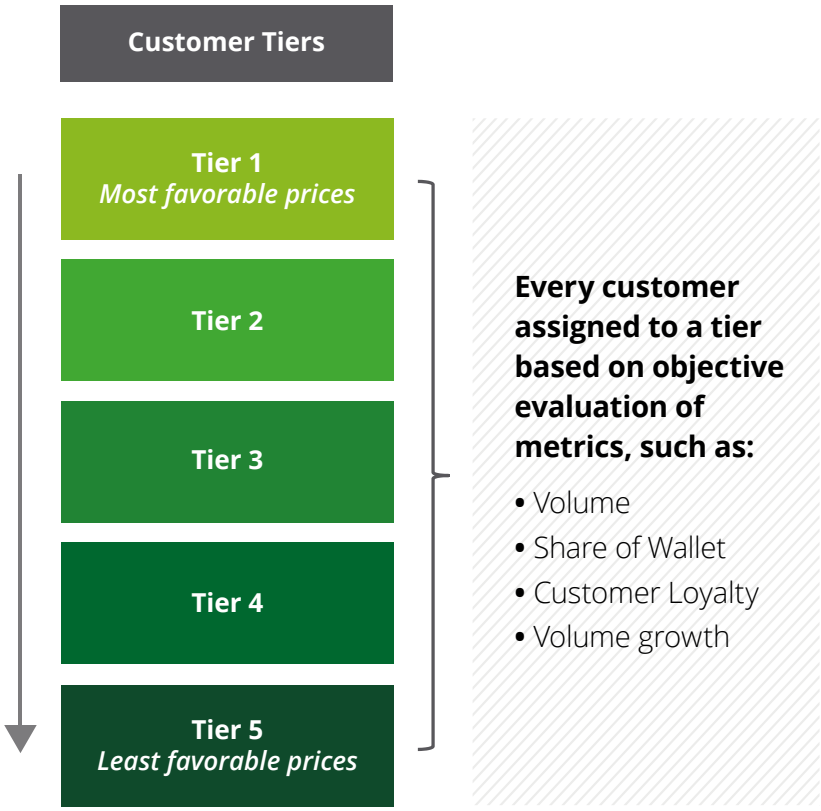
iii. Once the value has been established, determine how much of that value should be captured based on priority variables like input costs, job level characteristics (e.g., after-market potential, capacity utilization etc.), and situational variables (e.g., supply-demand dynamics) through the use of EVE® framework.

- **Customer Pricing:** We recognize there are instances where different customers are expected to pay different prices for the same product; the key is to differentiate in a structured, consistent and policy-driven manner. Variances in final price should reflect customer-specific differences in cost-to-serve, as well as customer engagement and behaviors. While there are several mechanisms that can be used to differentiate price by customer, there are typically two approaches that are leveraged.

  A. **Customer Tiers:** Segment customers into different tiers based on aligned-upon set of characteristics and objective evaluation of those characteristics. The price / discount and the service level that a customer receives then is based upon the tier they fall in. This approach provides a simple yet very disciplined way in which companies can manage their customer pricing. It also enables sales teams to provide clear guidance to customers on what will it take for them to get to the next tier and achieve better pricing with your.

  Here is an example of a customer tiering logic that was put in place by an industrial products manufacturer to provide standard discounts for day-to-day pricing, the tiering logic was based on objective measurement of volume and share of wallet. This structure helped the company significantly reduce their special allowances / adhoc discounts on a deal-by-deal basis while rewarding their larger, most valuable customers thereby increasing their margin and volume simultaneously.

Figure 5: Illustrative Customer Tiering Logic



B. Price Menu: The other approach that is typically employed is the development of a price menu. The approach entails establishing a menu of service needs and discount criteria that provides effective structures for catering to customers' bundling preferences while also creating additional incentives and discount programs. The approach allows for more granular pricing as compared to customer tiers and but still does so in an objective manner instead of an ad hoc way and drives consistency.

Here is an example of a price menu that was designed for an industrial equipment manufacturer to provide granular options to the customers.

Figure 6: Illustrative Price Menu and Discounting Program

Servicing Needs

		Bundles driven by target segments' likely needs		
Products (per lb)	**"Core"**	**Package A**	**Package B**	**Package C**
AAA Series	$0.6600			
BBB Series	$0.5850			
Grade A, B, C, D	$0.5875			
Grade A, B, C, D	$0.5600			
Services — Packaging (per lb)				
Paper Bag	$0.0425			
Polyethylene Bag	$0.0450			
Direct from Warehouse	$0.1000			Incl.
Bulk Bags (>xxx lbs)	$0.0225		Incl.	
Bulk Bags (<yyy lbs)	$0.0325			
Services — Other (per lb)				
Split Container	$0.0050	Incl.		
30-Day Terms	$0.0025	Incl.		Incl.
Special Packaging	$0.0025	Incl.		
Customer Coding	$0.0025	Incl.		Incl.
Rush Order[2.1]	$0.0350	Incl.	Incl.	Incl.
Service Package Price	**$X.XXXX**	**$0.0400**	**$0.0500**	**$0.0380**

Relationship Discount

Discount Criteria:

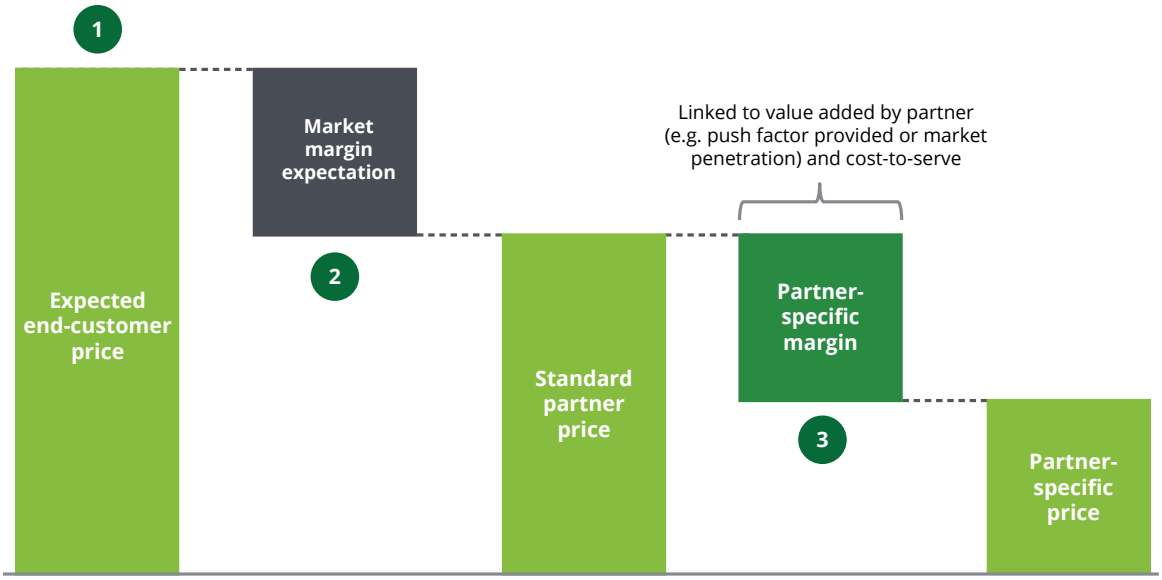
	Total Volume (lbs)	Discount[2.2]
1.1	x to y	10%
1.2	y to z	15%
1.3	z to a	20%

Terms

2.1 Rush order volumes only
2.2 Discount is on incremental volume

- **Channel Pricing:** Finally, our experience indicates that the channel pricing strategy should be built on a 'customer-back' perspective, rather than the typically adopted 'company-outward' approach. Channel pricing strategies should be built on a deliberate price target to the end customer, combined with surgical margin expectations for channel partners. Margin expectations should be anchored in the exchange of value between channel partners; is your partner providing a 'pull' force for demand or are you creating the channel volume 'push'? Channel pricing also needs to align directly to your broader channel strategy; do your partner incentives reflect prioritized routes to market?

Figure 7: Channel pricing and margin expectation framework



1. Anchor on **end-customer price** as the starting point
2. Adjusted based on **minimum target margin**
3. Additional margin linked to **partner characteristics and behaviors**

These pillars of product, customer and channel pricing provide a holistic framework that will allow you to be competitive where you must be, while ensuring that you also capture incremental margin where you should. With the right logic and surgical application, your business can get to the right price for every deal.

Part 3: Debunking the margin vs. volume trade-off

Complexity in B2B2C environment can be a source of advantage that provides the opportunity for deliberate and surgical pricing strategies to drive margin AND volume growth simultaneously, enabling companies to achieve transformational commercial impact of 300-500 bps growth in EBITDA and increased market share[2]. Here is a case example of where have recently brought this to life.

Case snippet

A manufacturer serving the construction industry was looking to reduce customer churn, and improve margin and market share through more effective price structure. Their existing pricing structure was a complex mix of list prices, standard discounts, special discount, and rebates and incentives that were not consistently applied. And the underlying logic of the structure was a bit lost due to multiple hands-offs over the years. As a result, prices were highly negotiated, creating significant administrative burden (for both the company and their customers) and missed volume and margin opportunities.

We helped the company define and achieve their aspirational end-state of pricing which included:

- **Product Pricing:**
  a. Defined **product line pricing hierarchy**: clearly defined pricing differences between product lines that account for differences in the value, cost, and price sensitivity
  b. Established **guidelines for configuration options** within a product: an adder ladder framework with clearly defined basic option, categories of adders which went beyond the basic option, and price differences for each option based on value, cost, and price sensitivity
- **Customer pricing:**
  a. Defined **standard discount tiers** for customer pricing: clearly defined volume tiers based on volume and growth that provided an every-day market relevant price for customers, negating the need for deal-by-deal negotiation
  b. Established clearly defined **special discounting** guidelines around when / why special discounts apply and how much
  c. Re-designed customer **incentives** to drive desired customer behavior to reward loyalty and growth

As a result of this well-articulated price structure, the company was able to apply surgical price changes in specific areas of the business to drive both margin and volume growth simultaneously increasing the top-line by around 370 bps.

[2] Monitor Deloitte Analysis

What can you do right now?

Here are the **three things** that you can do right now:

01

Ask your product / pricing team when they last looked at the entire product portfolio and refreshed their price strategy and structures. Does the price structure take into account relative value that your products provide against competition?

02

Ask your account teams which customers are paying the highest and lowest prices? What does the price variation look like in between and does it align with your customer strategy?

03

Ask your sales / channel teams about the challenges they are facing across different channels. Does your channel pricing align with your strategy and do your prices drive desired behaviors in the marketplace?

Companies that leverage these complexities in B2B2C environment and use surgical pricing strategies to drive margin AND volume growth simultaneously are the ones that achieve exceptional business results and consistently outperform their peers.

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