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ENABLING MORE PROFITABLE PRICING IN WHOLESALE DISTRIBUTION

WHITEPAPER

SAP Silver Partner

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EXECUTIVE SUMMARY

Wholesale distributors face massive complexity, with thousands of products and customers, hundreds of sales reps, volatile costs and constantly evolving competitive dynamics, including increasing threats from non-traditional online competitors. As a result, distributors often struggle to set, manage and execute pricing strategies that simultaneously meet P&L objectives and enable sales representatives to win deals.

Pricing is by far the most effective profit lever available to any company. However, many distributors often set pricing in terms of overly broad target margin percentages, cost-plus rules or list-minus targets, and ultimately relegate final pricing decisions to the field. While well-intended, this approach results in lost margin and is largely unsustainable as margins are increasingly squeezed and digital channels become the norm. In fact, the majority of distributors are missing out on an achievable 100 to 300 basis points in incremental margin as a function of poor pricing.

Furthermore, inconsistent pricing compromises the customer experience. Wholesale distributors must provide real-time, consistent, personalized pricing to compete in today's marketplace. To do that, issues that have built up over time, across each of the price types that exist in distribution, must be systematically addressed.

The ideal solution holistically addresses price setting, optimization and management challenges while seamlessly integrating with best-in-class ERP, order management, CPQ and commerce solutions, tying pricing strategy to execution and results.

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THE CASE FOR CHANGE

The average B2B distributor is losing 0.6% to 5.2% of profit each year due to misaligned market pricing and 1.4% to 6.5% because of inconsistent pricing practices, based on benchmark data.

Misaligned pricing refers to transacting business at prices that fail to align rationally to customer size, order size, product value (good-better-best) and other key value dimensions. For example, a small customer may receive a better price than a large customer for the same product, all else being equal. It also includes pricing that does not quickly and accurately account for cost changes. Risk exposure to the latter is only increasing as cost changes occur more frequently and unpredictably in a global recessionary environment.

Inconsistent pricing means that prices are transacted below a minimum margin threshold, showing exceedingly wide variances under similar selling circumstances. Price grooving is also a common source of margin leakage, creating inconsistent prices where prices are rounded to the nearest dollar or offered at only discrete margins, such as 30%, where perhaps a margin of 33.5% would have been sufficient to win the deal.

No one sets out to make these kinds of pricing mistakes. So why do they occur? Pricing in wholesale distribution is difficult due to the acceleration of external pricing triggers in modern business coupled with outmoded internal processes that can't scale to meet the moment. Pricing teams are constantly in a reactive position – trying to pass through increasingly frequent cost changes, setting a pricing strategy that sales reps will honor, making quick decisions based on inventory, or keeping up with the omnichannel demands of customers. In many distribution companies, especially those that are branch-based, pricing is decentralized. They are not set up to learn from mistakes happening in far-flung field offices nor can they effectively set and govern a true holistic pricing strategy. Without the technology toolset and ability to analyze a massive volume of data and collaborate within a single source of pricing truth, distributors find themselves forever behind the market, leaking margin all the while.

COMMON PRICE MODE CHALLENGES IN WHOLESALE DISTRIBUTION

Pricing typically takes on similar forms across the wholesale distribution industry. A company's price modes (pricing architecture) each have their place but tend to drift away from their original intent and are used inconsistently. A price mode is a framework for understanding how a company arrives at a price for a given customer. Here are the four main price modes and common problems wholesale distributors run into with each:

List Price

- Price lists tend to quickly become stale, as product-value relationships, such as good-better-best and private labels are not reflected and cost changes are not pushed through intelligently or quickly enough.
- List prices should be a company's North Star, the reference point for discounts. The increasing number of products, relationships and competitive considerations often render the list price meaningless when managed manually, and therefore unusable as a reference price.
- Distributors often further complicate list prices by artificially inflating the price to try to influence pricing decisions made by sales reps — a tactic that rarely works in practice.

Matrix/System Price – Grid where groups of similar customers and products are assigned to specific matrices. When assigned correctly, this can be the most profitable price mode. However,

- Often sales reps have the power to reassign customers to more favorable price tiers, causing nearly all customers to get the lowest price. This, combined with stale list price reference values, causes customers to be mis-assigned and receive prices that don't reflect their relationship with the distributor.
- Matrix prices often lack the proper level of granularity, or dimensions, to ensure the prices are market-aligned and competitive enough to win the deal; thus they are ignored by the sales reps in favor of overrides and special price exceptions. Data science-driven price segmentation, which accounts for the customer, product and order dimensions that statistically influence price response, is required to achieve the necessary granularity to make prices relevant and gain market adoption. Establishing this segmentation structure may exceed the resources available in-house.

- As costs change, matrix prices are often cumbersome and difficult to update. Even when this process is relatively efficient, if a small percentage of revenue is transacted on the matrix, companies may only recoup a small portion of a cost increase through price, as other price modes are harder to immediately affect.

Customer-Specific Prices – Two types in this category, customer-specific price exceptions and customer contracts (largest and most valuable customers)

- Distributors often see a proliferation of customer-specific price exceptions when matrix prices are not market-aligned. These often lead to margin leakage due to poor price initial setting, poor record creation/management, lack of an approval and ongoing review process, and a fundamental lack of strategy behind the process.
- It's not uncommon for hundreds of thousands to millions of these pricing records to exist in a distributor's business, creating an overwhelming administrative burden, and making it difficult to impossible to execute price changes as costs or other dynamics change.
- Many price exceptions are set with no expiration date, at a net price level or a generic markup over cost and fall victim to the "set and forget" conundrum.
- Since customer contracts are reserved for key customers, sales reps are very protective of them. It can be a challenge to enact a price increase, regardless of how outdated the contract.

Override Prices – Prices that, for any number of legitimate reasons, are deviated from list or matrix in a one-off, negotiated capacity.

- When left without guardrails, these can lead to rampant over-discounting, based on rule-of-thumb margin targets, inconsistent prices from rep-to-rep or branch-to-branch, and misaligned prices.
- Attempts to institute approval processes can often result in delays and lower win rates, if not instituted appropriately.

AN INTEGRATED PRICING SOLUTION IS NECESSARY

Solving for these pricing challenges requires investment in people, processes and technology to efficiently and effectively set, optimize, manage, execute and deliver prices in all go-to-market channels. Pricing teams need intelligent tools and reliable data when setting prices for each price mode so that distributors can begin to use price a strategic lever to improve financial performance. Sales reps need market-aligned price guidance to make the best possible commercial decisions. Finally, customers expect price transparency and consistency, regardless of the sales channel.

There is cloud-native technology available that accomplishes each of these use cases and more. Read on to learn how best-in-class distributors approach pricing, seamlessly integrated with SAP® S/4HANA and SAP Customer Experience Portfolio, including SAP Commerce Cloud and SAP Sales Cloud.

A REIMAGINED APPROACH TO ADDRESSING DISTRIBUTION PRICING CHALLENGES

As outlined above, wholesale distributors are met with unpredictable pricing triggers at increasing speed and struggle to orchestrate the comprehensive pricing processes to overcome those obstacles. Cloud-native price optimization and management solutions are up to the task of addressing these obstacles with precision and scale.

One of the major hindrances to tackling a pricing project built on a data science model is the common fear among distributors that their underlying data is faulty. In reality, B2B companies have more readily usable data than they realize. The transaction, customer and product master data residing in an ERP system, is just waiting to be mined by an intelligent pricing system. This is typically the cleanest and most reliable source of data and becomes the foundation of a price optimization and/or price management model.

Data inputs can be integrated from an unlimited number of sources to a price optimization and management system via a flat file batch process or through a high-availability REST API.

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Pricing outputs from the pricing system can be integrated via batch process or a real-time integration that does not require data uploads to ERP systems. As an example, real-time API calls can be made from SAP S/4HANA® to Zilliant to return the right price condition value. This eliminates the technical challenges of mass uploading to an ERP and allows companies to optimize prices at a more granular level and modify guidance at the speed of the digital world.

It's incumbent upon distributors to take a smarter approach to pricing to fully realize the enormous potential of investments in CPQ, ERP systems and commerce solutions. Connecting these solutions via REST API to a true cloud-native price optimization and management platform enhances a distributor's pricing function by:

- Allowing pricing teams to set optimized, market-aligned prices that are contextually relevant for every selling circumstance
- Empowering pricing what-if scenarios to determine the predicted revenue and margin impacts of different pricing strategies and decisions
- Enabling pricing teams to intelligently respond to dynamic changes in market conditions, better meet customers' expectations, and publish prices in real-time directly into CPQ, commerce or ERP systems
- Accurately measuring the impact of pricing strategies on business performance

Wholesale distributors who have taken this approach are more responsive to customers with relevant prices and give their sales teams the upper hand in negotiations. When reps receive guidance that shows them the logic and business impact behind each product price, along with warnings if they are approaching the price floor, approval workflows are drastically reduced. Armed with the most competitive, market-aligned prices directly in their quoting system, sellers walk into deals with confidence.

Pricing teams benefit from a far superior 1-2 punch of price administration and price execution. Price management is fundamentally a business process challenge because many stakeholders exist across the enterprise who each have their own perception of what price should be and have developed unique

methods to support their functional silo. A centralized price management system supported by a rules engine gives stakeholders across the business visibility into what each price is, why it was set, how costs are passed through and how price varies depending on volume/customer/region/etc. When used in concert with a price optimization solution that can consume and analyze vast swaths of pricing data and account for all the factors that influence price, companies report near-immediate ROI.

According to the IDC MarketScape: Worldwide B2B-Focused Price Optimization Applications 2018 Vendor Assessment, the value from price optimization applications is demonstrable and the payback is short, with many companies reporting payback in less than 12 months, and some in as few as 3 months.

Terreal, a manufacturer of clay building materials, realized sustained margin and pricing improvement from deploying price optimization. "We've managed to increase our margin by 0.3 points per year for the past three years, we've managed to perform better than our industry by 0.4 points in terms of price, and we've managed to continue to gain market share 0.5 points per year in the past four years," said Jean-Baptiste Fayet, VP of Sales and Marketing at Terreal. View the Terreal story here.

An additional benefit to this connected system is the full picture of data that emerges when powerful cloud-based systems talk to each other. The pricing platform can collect win/loss data from CPQ and ingest data collected from eCommerce solutions, such as cart abandonment data, to enhance its elasticity measurements.

ENABLE SMARTER PRICING, FASTER

Once a price optimization and management solution is in place, ensuring the market-aligned prices it produces are acted on in the field and presented to customers under the right selling circumstances is key to realizing financial benefit. In most distribution businesses, that happens through a combination of a configure price quote (CPQ) tool, eCommerce channel, and/or ERP system for direct order entry.

The CPQ market has come of age in the past half-decade as more and more B2B companies invest in more efficient quoting processes. However, to get the full value of CPQ, companies must also focus on providing high-quality price guidance within the CPQ solution, which is no small task given the complexity of the price setting and management process for most wholesale distributors. When pricing guidance is market-aligned and delivered within CPQ, distributors are better able to:

- Improve the speed and effectiveness of pricing decisions within the quoting process
- Ensure price guidance in CPQ reflects up-to-date pricing strategies and market and cost changes
- Increase sales confidence by providing contextual analytics, including historical prices paid by other customers in the same pricing segment, and scoring price quality
- Simplify a complex quoting process by dynamically optimizing line-item pricing with order-level targets
- Accelerate quote turnaround time with real-time approval guidance

Distributors without a CPQ tool can still benefit from optimized prices. With slight modifications to the order entry screen, optimized negotiation guidance, in the form of start, target and floor prices, can be displayed in an ERP order entry screen for sales reps and customer service reps to use at the time of order.

Online entrants to distribution are quickly disrupting the status quo. As a result, distributors are making significant investments in commerce solutions to remain competitive. Pricing strategy is often an afterthought in many distributors' digital strategies, yet it is also the biggest stumbling block. It can

make or break the customer experience, as modern B2B buyers are online-savvy and expect a B2C-style experience and competitive, market-aligned prices. In a world where most distributors allow salespeople to set the price for the customer, this presents a huge challenge.

Integrating SAP Commerce Cloud® with an advanced pricing optimization and management solution allows for dynamic, real-time price updates, price consistency with offline channels, and price personalization based on each unique customer's relationship with the distributor, as well as intelligent automated negotiation functionality.

ONE INTEGRATED PRICING SOLUTION

How do all these concepts come together to create one dynamic system of commercial excellence? Zilliant has teamed up with SAP to provide SAP Customer Experience Portfolio (including CPQ and Commerce Cloud) and SAP S/4HANA customers easy access to Zilliant's market-leading price optimization & management solutions, including:

- Zilliant Price Manager, which allows users to set, manage and update prices for all price modes using a rules-based approach; make mass updates to price lists; execute and publish pricing initiatives to sales reps; and build statistically and strategically relevant segmentation structures.
- Zilliant Price IQ™, which is a data science-driven price optimization application that accounts for all statistically significant factors that drive price response, rationally aligns price/customer/order/product relationships and measures price elasticity with win-only data to set profit-maximizing or revenue-maximizing prices, based on a company's P&L goals. It uses constraint-based optimization to simultaneously enforce business rules, includes a Strategy Interface to run predictive what-if scenarios, and produces optimized price guidance for all the different way price is expressed in a business.

Zilliant's cloud-native SaaS platform uses high-availability REST APIs to infuse SAP solutions with intelligent pricing, enabling companies to make better pricing decisions, faster.

With Zilliant's pricing solutions seamlessly integrated, wholesale distributors are able to maximize their SAP technology investment while quickly strengthening commercial performance in a tumultuous marketplace. For more information, visit us on the SAP App Center.