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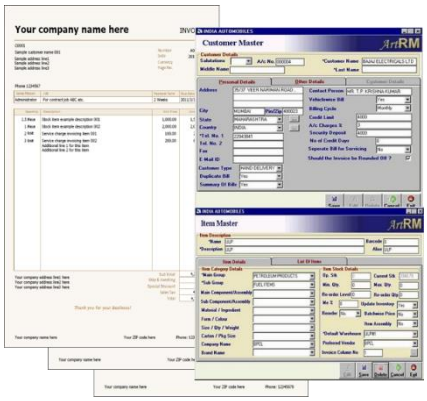
B2B Price Segmentation: Pitfalls to Avoid

1. Suboptimal Choice of Attributes and Inputs



Limiting data to "readily available" attributes may get your segmentation project off to a quick start. However, leaving out important attributes leads to less credible outputs that may not properly reflect the complexities of real life markets.

Another pitfall is reducing segmentation to a mathematical exercise, thinking "the data alone should tell us what to do". This can lead to outputs that are less informed by industry/business insights, have less credibility with key stakeholders, and are not strongly aligned with business strategies (which may call for a deviating from historical trends).

We advocate discovery to carefully choose/ gather attributes for consideration, as well as using a segmentation process that mixes sophisticated mathematics and sound business judgment.

2. Overly Simplistic Analytical / Mathematical Approaches

A common B2B price segmentation approach, often deployed by consultants and analysts, is to develop a price segmentation matrix using business judgment, making use of potentially available BI/dashboarding tools/ applications. "Advanced" versions of these matrix segmentation approaches (including some mid-market B2B pricing tools on the market) aggregate attributes by way of scoring models, to keep final matrix structures simpler. Segmentation outputs are validated by demonstrating that the average ("mean") historical price charged in each segment aligns with the segmentation logic, despite possibly numerous outliers. Outliers (often described as past pricing errors to be corrected) may be found using standard deviation measures.

While these approaches leverage basic statistical tools (such as means and standard deviations), they are not sufficiently robust to do justice to B2B segmentation challenges faced by complex business organizations. These simplistic approaches can pose problems for several reasons (explaining why these mid-market pricing tools are getting mixed results in terms of real-life adoption). Specifically, these approaches too often yield price segments that are:

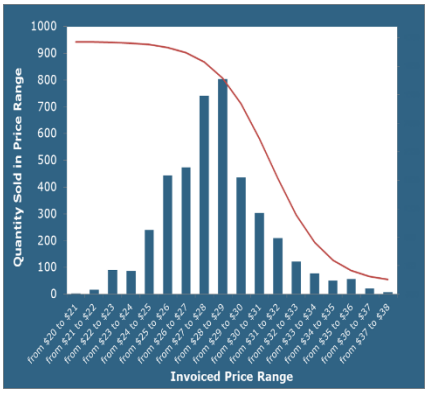
- too small, no sufficient data for statistical validity
- too large/not refined enough to reflect real-life complexities, i.e., because the analyst did not complicate the matrix model by adding additional attributes/dimensions (some of which may actually be highly relevant in parts of the business)
- have enough data to be statistically valid, but yield statistical price distributions that do not resemble "bell curves"

The "lack of bell curves" issue is often viewed as evidence that pricing practices were historically "out of control." In reality, however, a different set of factors may be the reason why segment-specific price distributions do not make sense. Here is some food for thought.

It is often possible for informed business users to "dream up" many different permutations of a segmentation matrix (i.e., by choosing slightly different attributes in different orders, by applying different weights to them, etc.). It is often also possible to validate many of those permutations using segment-specific average price histories. Although a limited number of alternative permutations may be reviewed, the ultimate choice of the specific to be used often reflects individuals' business judgment.

"Segmentation artists" building these matrices may feel confident in their "common sense" logic, and they may also feel that the data backs them. Still, their output is often not easy to implement, and it falls short of a world-class, scientifically sound solution.

In world-class, scientifically sound solutions, sophisticated multivariate regression "data mining" tools (particularly the types of flexible segmentation models that resemble decision trees, which are integral to the science used by most top-rated B2B price optimization solution vendors) are used to "guide the segmentation artist's brush." These tools can help ensure that the most effective segmentation structure is derived: the structure with the most statistically valid segments, where the distributions most closely resemble "bell curves" (where segment specific average prices are actually meaningful benchmarks for transactions within a segment). The resulting statistically sound segmentation structures more closely reflect the historical collective judgment of those involved in price management. Furthermore, the flexibility of "decision tree" like segmentation approaches allows for the "segmentation artist" to incorporate business judgment and strategy, and vary the weights of attributes across different parts of the business. Finally, the implementation of such price structures can involve less change, less risk, and – especially if the science is transparent (i.e., not mysteriously hidden in a "black box") – often allows for more effective change management, relatively speaking.



3. Execution Failures

Unfortunately, the execution challenges associated with rolling out a new price structure are often underestimated.

Executive commitment, along with controls (measurements, KPIs, etc.), and also incentives should be considered, so execution can proceed smoothly. Ongoing communication throughout the project is critical, so stakeholders do not feel like they are being "hit out of left field". While the goal of any training or communication should not be to turn folks into pricing scientists, a healthy balance exists between treating the training audience as "adults", and providing potentially confusing/overly complex information.

Similarly, ERP/IT systems issues should be being worked on throughout the project, to ensure that it is possible to implement the new segmentation/price structure at the time it is to be launched.