B2B DISTRIBUTOR'S GUIDE TO GETTING SALES TEAMS TO PRACTICE VALUE-BASED PRICING/SELLING

Why Do B2B Distributors Fall Short of Charging Prices That Capture Their True Market Value?

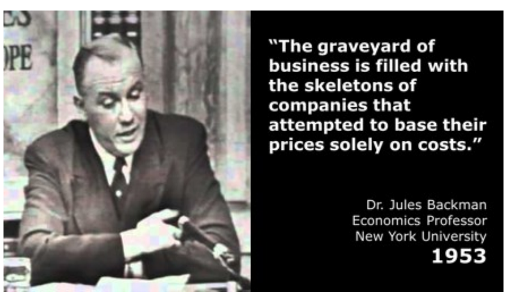
Many B2B distributors trust industry-veteran sales reps with pricing/discounting decisions. Reps may also be provided with cost/margin information, as well as the ability to view customer-specific pricing/invoicing histories, so they can make more informed pricing decisions.

These distributors tend to rely on the rep's judgment, along with some level of controls and incentives, that the rep will sell the distributor's value. They trust that the reps will properly apply their industry knowledge and their understanding of customer-specific circumstances – and that they will discount only when, and only to the extent necessary. What can go wrong when this approach is taken, and why?

If sales reps do not have enough confidence that HQ-managed system/target prices are market-aligned, they often (rightfully) feel that they need to adjust/override. Discounting is in fact necessary if system process are misaligned with market conditions. Unfortunately, this type of situation frequently leads to patterns of rampant, hard-to-control over-discounting behavior across much of the sales force.

"Consider what would happen to your profits, if you could curtail unnecessary over-discounting, become "better" at pricing, and improve your average selling prices by 1 or 2 percent, without adversely impacting volume?"

Reps in these situations effectively act as individual pricing managers, determining on their own what might constitute a "reasonable"/market-aligned price (or markup) for a specific customer/item combination. To make this determination, they rely on information displayed/available in the ERP (margin/cost data, customer-specific price histories), along with their own individual experiences with the particular type of customer and product involved.



In real-life, complex distribution pricing environments, where portfolios often comprise thousands of products and customers, it can be challenging for even the most tenured reps to make such pricing determinations in a consistent, optimal fashion. Understandably, reps tend to err on the side of over-discounting, opting to forego a bit of margin, rather than taking risk of losing the sale/upsetting their customer. Over time, they may also develop "rules of thumb" discounting habits ("I just charge X%") – and these habits do not necessarily change with evolving market conditions (e.g., stronger branding, better/more competitive service levels or cost positions, etc.). In a sense, by using "rules of thumbs," reps trade off some precision for efficiency. If these habits are allowed to perpetuate, discounting may become routine: it can become a knee-jerk reaction to a customer asking about prices, or to a piece of margin data displayed on an order entry screen – without real consideration to customer/market value.

Until somebody does the math, this may seem like a reasonable world to live in. But consider the potential profit impact, if you could curtail unnecessary over-discounting, become "better" at pricing, and improve your average selling prices by 1 or 2 percent, without adversely impacting volume? Such gains are typically achievable, and they represent ROIs well in excess of typical "lean" initiatives and other strategic projects in B2B distribution. By embracing the right set of tools, distributors can curtail unnecessarily giving away product cost savings, customer-value generating add-ons/services, and other key features of the distributor's offering – which often come to exist as a result of great effort/investment by the distributor's management.

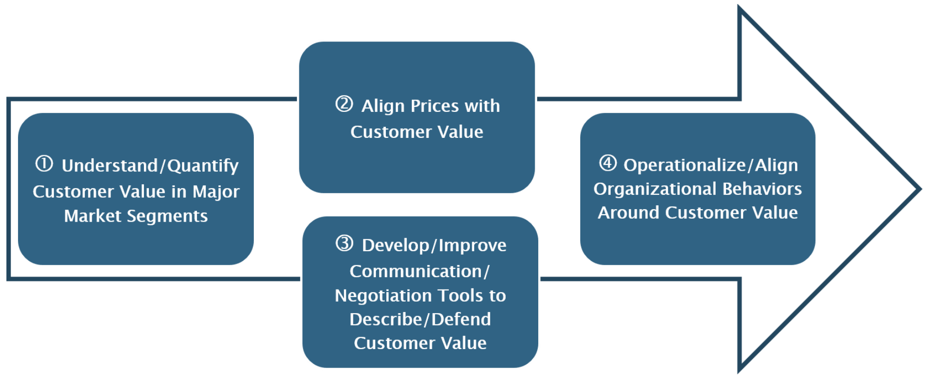
VALUE BASED PRICING MYTHS & PITFALLS

MYTH: Value based approaches do not work, because markets set prices for commodity products

Your distribution business is a key player in the marketplace, especially when it comes to the specific markets you play in. What you/your reps do, has a very real impact on the market's willingness to pay for your products and services!

Your distributorship may be too small to affect overall market conditions. Nonetheless, markets set price ranges, they do not set prices for specific transactions. Ask your reps: if they charged 1% more on every invoice last week, would they have lost most of the volume? Likely not! Even small distributors can improve their pricing practices, by understanding where segment-specific price ranges stand, and evaluating their pricing power to intelligently manage where in that range they want their prices to be positioned.

Market research consistently shows: customers rank several distributor program features ahead of "price" in their purchasing decision criteria. They want a supplier they can trust to have the right, quality supplies available to them when they need them. They want technical support. They also want a low price, as well as no-hassle returns. And many other things. Sales reps consistently overestimate the importance of price in the purchasing decision!



Developing a Value Based Pricing/Selling Capability: A 4 Step Process

Architecting an Effective Pricing/Sales Program to Drive "Value Capture"

Research confirms what most distribution executives intuitively recognize: businesses with effective value-based pricing/selling strategies outperform those that lack these capabilities, and rely on cost/margin-based techniques instead. Value-based pricing/selling tools are proven ways to help B2B distributors more effectively capture their fair share of the market value created by their distribution business. An effective roadmap to building a strategic value based pricing/selling capability in B2B distribution includes the following 4 steps:

① Understand/Quantify Customer Value in Major Market Segments

In this step, the distributor develops a capability to analyze/quantify the benefits that different types of customers derive from doing business with the distributor. Linkages are identified between features of the distributor's offerings, and drivers of customer value in different market segments. Competitive intelligence is collected. Sample calculations are defined, to help quantify how particular value-drivers reduce customers' costs, and how they help drive customers' revenues, relative to applicable competitive alternatives. This analysis is performed at a segment level: different customer types may value different things, and different competitors may be at play in different industries, geographies, and product markets.

For example, a B2B distributor may find that its ability to provide emergency deliveries is key driver of value for many commercial contractors served by the business. After all, if the contractor's team is unable to proceed with a project because a part (which they might not have previously realized they would need) is missing, this can lead to inefficient labor utilization, and drive up the contractor's cost of completing the project by disproportionately higher amount than the cost of the part involved.

② Align Prices with Customer Value

In this step, the distributor leverages key learnings from step one to develop updated price matrices/price segmentation schemes, so the price structure better reflects how much value is being delivered in particular parts of the market. Depending on the extent of the distributor's pricing power in a particular segment, and depending on where historical system prices stood, in particular segments the analysis may suggest that the distributor should raise or lower system price points, to help ensure an appropriate balance between the need to be competitive, and not leaving money unnecessarily on the table. In high-transaction count distribution environments, the distributor's understanding of segment-specific willingness-to-pay levels may be refined using statistical methods to estimate the segment-specific elasticity of volume to price changes. The analysis results in a recommended set of revised, more value-aligned prices, which better reflect segment-specific levels of willingness-to-pay.

Accordingly, the B2B distributor in our example may choose to review its customer history data, and form different segments of contractor customers depending on their high, medium, or low usage patterns for emergency deliveries. If key competitors in the commercial contractor segment (such as online suppliers) do not provide a similarly reliable comprehensive emergency delivery service for across the types of products subject to emergency delivery requests, then the distributor may conclude that it has significant pricing power in the segment of "high frequency emergency delivery" customers, and update its price position accordingly.

③ Develop/Improve Communication/Negotiation Tools to Describe/Defend Customer Value

In this step, the distributor develops and deploys tools for use by its sales force, to help effectively convince customers that the prices being charged are justified by the value the customer derives from doing business with the distributor. These tools often include segment-specific value-messages/value props, and talk tracks. They should also include easy-to-reference libraries of sample calculations/logic to quantify customer benefits vs. relevant alternatives in key market segments.

In our example, the sales force would be trained to review easy-to-reference tools when pricing issues come up in customer discussions. If pricing comes in discussions with a high emergency deliveries usage" customer, these tools would quickly guide the sales rep to review recent customer-specific emergency delivery data, and present the rep with ready-to-use, relevant talk tracks/customer value calculation logic, to help describe the value of the distributor's emergency delivery service at the account (e.g., "what does it cost you when half of your team stands around for an hour doing nothing, because they are waiting on a part?").

Even if the distributor's sales force is well-equipped and trained to use these tools, certain customers will refuse to openly acknowledge the distributor's true value. Some of these customers may be "poker players" who actually derive significant benefit. To effectively deal with these types of customers, the distributor must also equip its sales force with tools to present price-value trade-offs in negotiations. Poker players want a lower price, but they will not want to sacrifice value to get it! Accordingly, in our example, the sales rep dealing with a poker-player "high emergency delivery usage" contractor could be guided to offer to the customer the option of implementing (or increasing) minimum order quantities or other fees for future emergency deliveries - in exchange for lowering some prices.

④ Operationalize/Align Organizational Behaviors Around Customer Value

In this step, the distributor's goal is to align organizational culture and processes to better support customer-value focus. Training programs are held to get everyone familiar with the new value communication/negotiation tools, and instill confidence across the organization that the price schedules generated by the updated pricing strategies are aligned with customer value (new price schedules may also be rolled out in this step 4). Training participants are challenged to transition from cost/margin-driven pricing philosophies, and realize that "profit" is not a dirty word: value-based pricing means capturing your fair share of the value your distribution business is creating for your customers. It is "fair" for your distribution business to capitalize from the investments you have been making in your business to better serve them!

It is often said: "what gets measured gets managed." Value based pricing/selling is no exception. Accordingly, in this step the distributor also develops reporting to gauge the effectiveness of the new pricing/value capture strategies. Such reporting can enable management not only to adjust tools and prices as market feedback is received, but also to leverage controls and incentive schemes to ensure the value pricing/selling tools are being utilized.

VALUE BASED PRICING MYTHS & PITFALLS

PITFALL: Assigning a Value Based Pricing/ Selling project to a team of sales reps

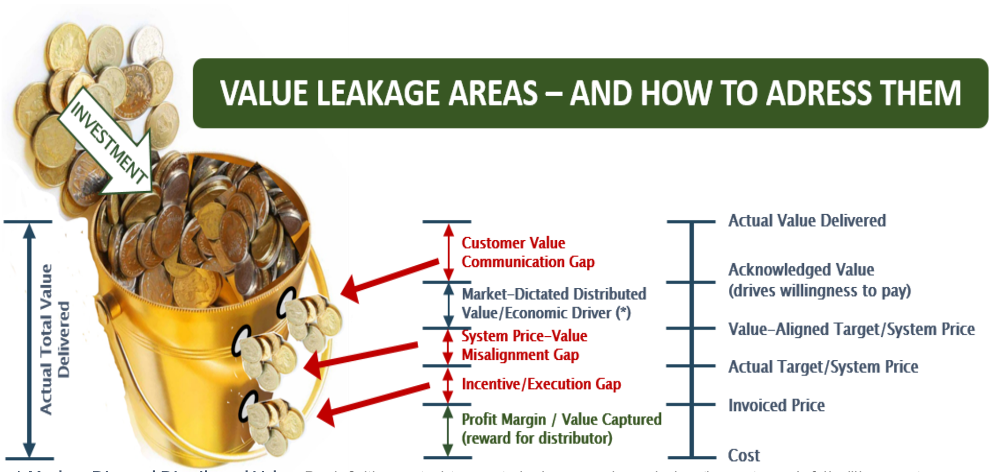
Sales rep input and engagement are critical to successfully operationalize value-based pricing/selling.

However, project teams led by sales reps are unlikely to architect an effective value-based pricing/selling program.

This is because:

- reps typically lack the necessary analytical skills
- they have insufficient bandwidth to devote to the project
- their attitudes are biased by their experiences of regularly dealing with customer price complaints (according to research and experience, this also leads reps to genuinely underestimate the true strengths of the distributor's value proposition).

A proven, effective way to involve reps is to invite a group of them to act as "advisors" to the core value-based pricing/selling project task force.



* **Market–Dictated Distributed Value:** By definition, actual transacted prices are always below the customer's full willingness to pay. Distributors must give up some value to their customers, simply because buyers will forego the purchase unless they derive a tangible benefit from the transaction.

Value Leaks in B2B Distribution

	Customer Value Communication Gap	System Price-Value Misalignment Gap	Incentive/Execution Gap
Key Questions	Can most of your sales reps defend your prices, by quantifying the tangible dollar value of the benefits that different customers derive from doing business with you?	• Do system prices reflect how much value the distributor brings to the table in different segments of the market? • Are profit dollars being left on the table in certain segments, because system price setting algorithms perpetuate historical pricing patterns (relying on "averages"), which may be driven by cost-driven pricing mentalities? • Is the distributor wondering whether the business may be pricing itself out of other segments, where system prices may be set significantly above market willingness to pay levels?	• Is discounting behavior being measured? Are sales reps held to credible benchmarks in how they exercise their discounting / pricing decisions? • On paper, do sales reps have significant incentives to defend your prices? In practice, do they have a real appreciation for the tangible impact of how their pricing/ discounting decisions impact their incentive schemes / comp levels?
Actions	Implement/ operationalize best sales practices (readily available, easy-to-reference libraries of value messages, talk tracks, customer value models, and negotiation tools), so all sales reps can confidently **show customers how your services are adding tangible dollar value** to their bottom lines/how your distribution business outperforms the competition in providing these services.	• Update price matrix definitions/ **segmentation schemes to include factors that drive customer value**, especially if segmentation schemes are driven by simplistic customer size/product velocity considerations. • Ensure that price setting algorithms **account for how much pricing power the distributor has** in specific segments. If algorithms are driven by segment averages (historical pricing patterns), update the algorithms to reflect customer value/ willingness to pay, and segment-specific elasticity.	• Implement reporting to gather market feedback, and also to enable the use of **controls and incentives** to affect sales rep behaviors. • Provide reps with timely reports / hard data on any tangible dollar impact that their pricing/ discounting decisions may have on their comp. • Bring price management into performance/coaching discussions!

VALUE BASED PRICING MYTHS & PITFALLS

PITFALL: Starting out by first focusing on the "value communication gap"

Distributors must equip their sales reps with weapons to communicate and defend value. They should not assume the reps will effectively develop such tools on their own, especially if revenue/sales growth tops everyone's agenda.

That said, sales force training on customer value communication is typically not the first step in an effective value-based pricing/selling initiative.

Even the best value communication tools will be left unused if:

- the reps lack confidence that system prices are value/market-aligned
- effective incentives/ controls do not drive the reps to extend effort
- the reps do not find that available value communication tools are practical and easy-to-reference.

Asking reps to communicate/defend value won't help, if you have not done your homework (plus, most professional sales reps already know they are supposed to sell customers on benefits)!