



Driving Cash and Profit Enhancements Where the Rubber Meets the Road

Transaction level pricing wins cash and profitability battles. In other articles in our pricing series, we discussed opportunities for price improvement at the industry and market levels. However, initiatives at these levels rely on pricing at the transaction level for effectiveness. Transaction level pricing is what is used by the sales team in deciding the exact price to assign each sale. Transaction pricing is how companies with great products (and some not-so-great ones) get prices that reflect their products' value on a sale-by-sale basis in each customer sale.

There are several useful tools to identify price revenue opportunities at the transactional level. It should be noted though that all of them require analysis and trending of transaction data. Some companies struggle with this, not because of the analytics that are required, but because the data required to support the analyses are not collected or stored in a form that is useful. Read on, and if this is your case, perhaps the opportunities will inspire your company to change price data collection and reporting practices.

Here we will address two fundamental approaches to transaction level pricing management; price band analysis and pocket price analysis. There are other tools to realize margin lift and cash flow using price management. If you want to learn more about these tools, information is provided at the end of the article.

Price band analysis is used to identify and review variances among a large number of customers in the price charged for a single product or service. To conduct a price band analysis, first gather data on the actual price paid (net discounts, etc.) by each customer for the given product or service at the order level. Ideally all sales for a single period of time such as the previous year are analyzed. If a customer buys multiple times in the period, there should be multiple orders represented in the data set. Later trends within a customer's price pattern can be analyzed, but here the focus is at the order (transaction) level.

Divide the range of prices into 20 or so bands. If the price ranges from \$0 to \$100, organize it into \$5 increments. Draw a bar chart showing how many orders fall into each band. The result is typically a bell-shaped bar chart showing more orders in a middle band and fewer orders on the fringes. Almost immediately, ideas should just jump off the page in the form of questions:

- Are there many at zero? Are these warranty claims or free samples? Is there a quality or sales strategy lesson to be learned?
- How wide is the area that represents prices below the midpoint? Can we move these up toward the average through policy changes or sales training?

- Are there spikes that tell us things about our behavior? Spikes often show psychological thresholds that may be at work. It's not unusual to see spikes around even numbers like 100 that might indicate that the sales team is jumping to a particular price based upon their own expectations rather than each individual customer's perception of value.
- Do customers at the high end of the price range perceive value that some of the lower end customers do not currently perceive? Can we get the lower end customers to perceive that value and raise the price?
- Can the whole band be shifted resulting in a higher midpoint?

You will want to run down explanations for each of these questions and when change behaviors where appropriate.

The second fundamental tool, the price waterfall, is used to identify the discounts, rebates, trade allowances and other invoice and off-invoice items that are subtracted from the list price. This analysis reveals the true final price, commonly called the net price or "pocket price". This analysis develops a bar chart indicating where margin is lost between the list price and pocket price. This chart is also an eye opener because often the number and variety of discounts that go unnoticed. The sales team and company leadership understand that several discounts are available. Often times though, they simply don't understand how many are at play in a given order. Here are a few examples of discounts you should be looking for:

- Free freight
- Coupons
- Salesperson's discretion
- Competitive situation discount
- Sales Manager discretion
- President's discretion
- Bulk or volume discount
- Free options or accessories

Showing the impact of these behaviors on average selling price can be very dramatic. Particularly when you take into account the number of sales at "list" price required to replace each freebie in order to maintain profit levels. Once the size and scope of discounting behavior is understood, a management approach can be put into place to manage the pocket price customers are paying. **The power of this approach is that it increases price performance without raising list prices.** This is a great strategy in industries or economies with downward price pressure.

Price band analysis and the price waterfall are two powerful tools that can be used to identify significant opportunities to enhance both profitability and cash flow. Even in well run, Fortune listed companies, with a leadership position in a market there are commonly 1-3% point opportunities that can be uncovered using these two tools. The reason for this is that the data are not generally provided in readily digestible form by ERP tools and pricing is not a discipline which has found general adoption with business.