Pricing complexity in high-volume industries: Putting the building blocks in place

A client of mine manufactured and distributed over 100,000 different electrical components and had a huge pricing problem. They sold to roughly 10,000 customers, many of whom had negotiated individual prices for many of the products they purchased. They were managing roughly 10 million different negotiated price points with different expiration dates and terms. I asked the VP of Sales how, with all that complexity, they managed to give customers the right prices on their orders. She laughed and said they were happy just to find any price to put on the order, let alone the right price.

As expected this caused significant problems for the company:

- **Customer claims when prices were erroneously high**. Customers would often call in when invoiced prices were above their recollection of what they had negotiated. Inevitably, the company would wind up crediting the customer for the difference. Such credits accounted for roughly 2% of revenues; a huge problem in a low margin business.
- **Lost revenue when prices were erroneously low.** When invoiced prices were below customers' understanding of negotiated prices, they wouldn't say anything; resulting in lost revenue that the company never even knew about.
- **Tremendous overhead costs.** Managing the systems and communication around pricing were tremendously burdensome, requiring a staff of 12 plus countless hours from sales people to address issues.
- **Inability to price strategically.** Most importantly, the company's lack of control around pricing made it almost impossible to price different products to specific customers in a manner that maximized contribution margin. In many cases, customer service representatives set prices seemingly at random when customers called in to place orders.

Unfortunately, this issue is somewhat pervasive in many industries with high volumes and a tremendous number of products. If your company is facing similar challenges, remedying the situation requires five simple building blocks:

1. **Establish a single, meaningful list price.** The reality of business is that you often have to negotiate. Everyone wants to think they're getting a good deal. However, when you negotiate from different starting points, confusion ensues. Everyone needs to be talking the same language in pricing and doing that requires that every product have exactly one list price at any one point in time. Also, list prices have to be meaningful. If customers are receiving prices that amount to 80% discounts from list, the list price isn't very meaningful and you lose credibility in negotiations because customers perceive (perhaps rightly so) that you don't have your act together and can be convinced to take a lower price.

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2. **Manage customer pricing as rules-based adjustments to list prices.** Assuming a solid price list, negotiate and manage all deviations from list price as a set of rules rather than separate prices. For example, if all customers receive a 10% discount on a product that costs $100, track the rule of discounting list price by 10% for that product rather than storing a price of $90 for each customer separately.
3. **Keep negotiations to a minimum.** Negotiation should be avoided wherever possible; especially on items that don't account for a large portion of customer spend. The key to making this work is to come in with reasonable prices on these items from the start. For example, large customers may automatically receive a 15% discount on a particular product line. No negotiation. A simple rule like that can eliminate the need to manage a few thousand price points (not to mention improving financial results). If it's not a huge percentage of spend, most customers won't object.
4. **Maintain maximum negotiation tolerances.** Establish a set of rules for how far negotiations can go. For example, your largest customers can receive a maximum discount from list of 15% on a certain product line while your medium size customers receive a maximum of 12%. Yes, you'll still have to store the actual negotiated discount level, but such a rule prevents huge, unprofitable prices and can minimize the volume of customized pricing by storing negations at a product line level rather than at the single product level.
5. **Align employee compensation with getting better prices.** Employees who impact pricing decisions need to have their compensation affected by the decisions they make. With limited or no incentive to obtain contribution margin for the company, employees will usually do whatever it takes to get the deal done; even if that means a loss for your company.

While putting these building blocks in place could require some systems changes, often much can be done through data manipulation using current systems. Once the building blocks are in place and the bleeding is stopped, your company will be equipped to begin making strategic pricing decisions and even using pricing optimization techniques to enhance profitability tremendously.

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