



# DISTRIBUTION COMPANIES TAKE NOTICE

*Stop Trying to Raise Prices  
Across the Board – It's Not  
Driving Profitability*

*By Francois Delvaux and Dan McLaughlin*

STRATEGIC PRICING GROUP  
A MEMBER OF MONITOR GROUP

## **Rethink What You're Doing**

The last five years have been rough for distributors...very rough. Price pressure and intense competition have eliminated razor thin margins, pushing many distributors to the brink. In addition, distributors have gotten into the habit of "giving away" value-added services in hope of winning deals, driving costs to historic heights. Many believed that a resurgent economy would allow them to raise prices, but customers have been resistant. For most distributors, attempts at price increases are simply not taking hold.

Fortunately, there is a better, more profitable approach. The solution is to develop products and services that target unique segments with very specific offers. For most distributors, this involves developing a range of offers from the high end (with all the bells and whistles) to the low end (no frills). The key is to segment the market and build specific offers based on your unique ability to drive economic value (e.g. revenue growth or cost reductions) for each chosen market segment.

For most distributors, this is a fundamentally new approach and supplants their basic one-size-fits all, volume-driven pricing model. And while most distributors conceptually

understand this strategy, most fear it because they've become locked into thinking that their

products and services are just basic commodities.

They couldn't be more wrong!

Based on years of working with distribution companies, we know that most don't fully understand how their customers value their products and services and get caught up in the mindset of "the way things usually work." Even the most commodity intensive business can improve revenue, margins and profits by adopting a value-based strategy that targets specific market segments with products and services that drive the economics of their customer's business.

## **Where to Begin**

Developing the right go-to-market strategy requires four steps for distributors:

1. Develop a deeper understanding of the value drivers for each market segment
2. Determine costs to serve those segments
3. Design specific offer and pricing structures specifically for those segments

4. Create organizational alignment and communicate value to the market

### **Understand the Value Drivers**

The goal of value analysis is to understand how your products and services create economic value for customers (i.e. how do our services help customers grow their revenue or reduce their costs?) and how value perceptions change across market segments. We are not referring to customer needs or product features and benefits, but more precisely, what elements of value drive a customer's business towards higher revenue and profit. Most distributors view customers more or less the same. Yet based on our experience with distributors, we know that there are vast differences in how various market segments value what distributors offer. Often, the most important and differentiated value elements are imbedded in the services that distributors provide, and those services are often given away for free. To understand where differentiated value is created, distributors should take a hard look at critical service elements such as:

- Pre-sale technical support
- Post-sale technical service
- Ordering methods
- Customer service
- Financing options
- Credit terms
- Freight charges
- Returns and claims
- Packaging

For example, we know of one distributor who provided extremely high levels of pre-sales technical support and configuration. So good in fact, that many of their prospective customers used them for technical advice in configuring solutions but then went on to procure the end product from a competitor at a lower price.

A good place to gain comprehensive knowledge of your value across customer segments is by reviewing your customers' historical usage of those services (i.e. how often did they use a particular service during a set time frame?). It is also important to

conduct in-depth interviews with customers to determine their motivations, the financial impact that the service created and where would they go if your company did not provide a particular service (i.e. understanding their next best alternatives).

### **Determine Cost-to-Serve**

Most distribution companies have good visibility of their product costs but a poor understanding of their costs to serve customers. By assigning costs to the services your company provides, distributors are able to assess a customer's true cost. However, simply knowing the cost-to-serve is insufficient. Costs must be compared to the prices actually paid by customers to understand where problems reside and where the potential for improvement exists. Especially in distribution companies, where products and services are typically bundled together under one price, there is a high potential to overcharge segments that don't need services and undercharge segments that are heavy consumers of services. In the first case, you run the risk of losing business because your prices are considered too high and in the second case, you run the risk of conducting highly unprofitable business.

Equipped with the knowledge of price and cost-to-serve, you can find those customers that abuse your services (i.e. pay a low price relative to usage) as well as find those customers that really do not need any service support and may have been overcharged. The end game is to develop a pricing structure that enables you to capture more from heavy users of services while at the same time not penalize light users.

### **Design Offering and Pricing Structures**

Once a company understands its value and cost-to-serve elements across customer segments, it can design an offering and pricing structure. The goal is to develop offerings that map to the value drivers in different segments while also being aligned with your own costs and capabilities.

Distributors should also consider using a tiered offering structure to capture customer value differences. Each tier of the offering

should have a different value proposition and price point (e.g. bronze, silver, gold packages). This structure can help reframe the value of your offerings by forcing customers to make explicit tradeoff decisions about what they receive for a certain price. Tiered offerings solve the problem of service abusers as well as satisfying “no frills” customers with offers packaged to meet each customer’s unique needs.

To ensure your customers don’t break pricing tiers and obtain more value for less money, it’s important to create price fences to ensure the integrity of your strategy. Fences can take a number of forms. In the airline industry, for example, advanced purchase time is used as a fence to prevent business travelers from purchasing discounted fares. For distribution companies, fences to consider include:

- Purchase location (e.g. ordering via web, customer service or field sales)
- Time of purchase (e.g. how far in advance of delivery the order is made?)
- Purchase quantity (e.g. volume, order or quantity requirements)
- Product design (e.g. differing versions of the product and service)
- Product bundles (e.g. different configurations of products and services)

### **Create Organizational Alignment**

For distribution companies, the path to strategic pricing needs to be well-planned and flawlessly executed. In most cases, this can be accomplished by creating a small, cross-functional team with top-management steering where pricing strategies and tactics are developed and monitored. It’s best to start small and identify problem accounts with margin leakages. The magnitude of the problem should be quantified to help raise its importance and bring organizational commitment. Initial success should be made early in the process and can be greatly improved by following several key guiding principals.

- You can’t optimize pricing strategy until you control the process.

- Hold someone responsible for the results
- Create a case for change
- Articulate pricing policies
- You can’t get the sales force to change how they sell until you bring them on board.
  - Convince them of the problem
  - Reward them for solving it
- You can’t expect your customers to change how they think about price and value until you change how you deal with them.
  - Understand their needs and adapt offerings to those needs
  - Understand and communicate value
  - Price with integrity
- You can’t control and monitor the process without appropriate systems.
  - Start with spreadsheet based tools to refine decision making
  - Build or buy systems that fit your organization’s needs

When it comes to the introduction of new pricing strategies, the “make or break issue” is often an organization’s ability to implement them. These changes are not easy. However, most distributors don’t have a choice. They must make changes to their pricing strategy or their competitors will beat them to it.

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Francois Delvaux and Dan McLaughlin are consultants in the Cambridge office of Strategic Pricing Group, a member of Monitor Group. They can be reached at [francois\\_delvaux@monitor.com](mailto:francois_delvaux@monitor.com) and [daniel\\_mclaughlin@monitor.com](mailto:daniel_mclaughlin@monitor.com).

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