

Playing every hand better in the pricing game



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With the influence of digital channels and more sophisticated procurement teams, pricing in B2B markets is more dynamic than ever.

To improve revenues and margins in this fast-changing environment, companies are looking to improve their pricing capabilities by combining advanced analytics with marketing and sales expertise.

In many business-to-business sectors, margins are under pressure as more sophisticated procurement teams search for cost savings from a growing array of high-quality suppliers, including some in emerging markets. In this more competitive environment, sales teams may be quicker to lower prices – especially if they know too little about competitors' prices or how much the customer is willing to pay.

In pricing, knowledge is power. Central pricing teams need to know enough to set the right limits on discounts for each geography and customer segment, for example. They also need the capacity and authority to prevent sales teams in the field from lowering prices too far.

Pricing speed is also increasingly important as online sales channels and instant quotes become table stakes in many B2B marketplaces. More buyers expect to be able to compare a wide range of prices and alternative products across vendors at any time. Indeed, we believe half of B2B sales will be made in digital channels by 2018. In this increasingly digital marketplace, more customers are willing to accept or even require dynamic pricing, just as they do when buying airline tickets, books, and Uber rides.

To improve revenues and margins in this fast-changing environment, some companies are improving their pricing capabilities by combining advanced analytics with marketing and sales expertise. They start by improving pricing transparency. With deeper knowledge of historical and competitive prices, sales teams understand more about where they're discounting and where they have to discount – and make those choices consciously, in some cases walking away from deals that won't be profitable.

As sales teams gain fact-based, real-time insights about pricing performance across customers, products, and markets, they learn where to draw the line on prices for each product in each negotiation, depending on goals that may range from maximizing profit to claiming beachheads in new industries. They can offer optimal prices instantly in digital channels to compete in a game that is moving online. And they learn how to tweak offers to win more business without lowering prices, for example, by offering better terms and conditions, just-in-time delivery, or easy returns.

Using a combination of richer data and superior analytics – along with capability building to help teams use the new tools – companies are improving ROS by 2-7% in 12-18 months, either as additional margins or versus a declining market.

We have found that a more scientific approach to pricing takes more than a black box: lasting improvements require an organizational journey and new mindsets. But by identifying actionable opportunities throughout that journey, companies can deliver quick wins to fund new advances and build buy-in.

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The four main pricing levers

Pricing in every situation is a two-step process – setting the right price and getting the right price from the customer. In each of these steps, we typically address 2 levers.

Price setting levers: Two levers can come into play: strategic or value pricing and SKU-level price setting. Value pricing defines the premium customers are willing to pay for a product or service based on the added value it brings compared to alternatives. SKU-level price optimization defines how regular prices are refined, taking into account multiple factors such as region, industry, customer size and type, competitive intensity, product application, expected margins, competitors' prices, and product architecture.

Salespeople don't have the time to calculate the value of all these factors and adjust them as market dynamics change, especially across hundreds or even thousands of products, so teams use crowd-sourcing methodologies and software to make the value-pricing process easier. When many SKUs need to be priced, such as in a spare parts purchase, a rules-based pricing method is required. In our experience, the best methods have fewer rules, which get combined into pricing strategies using weights. Teams can run these rules easily and frequently, allowing pricing managers to pick different strategies by product groups.

Price execution levers: The next process, getting the right price from the customer, includes reducing leakage and improving quotation and discounting. Teams begin with a review of deals and contracts, scanning existing customer relationships and agreements for inconsistent pricing and then defining corrective measures. To optimize discounts, they use a dynamic deal-scoring process, getting on-the-spot recommendations and seamless approvals from the central team. This approach, an increasingly popular way to get quick impact from pricing, is described in further detail below.

In our experience, teams typically achieve most of the impact from one or two of these levers depending on their current pricing capabilities, the industry, and the customer. Teams also tend to find more useful insights when they can review pricing performance in visual formats rather than in spreadsheets designed for financial managers. The exhibit shows how a team could use historical data to segment deals and understand price variability.

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We also find that companies benefit greatly when they adjust sales teams' incentives to more closely match strategic and financial goals. A 1% price hike might mean almost nothing in a typical commission scheme, for example, but it could represent a 20% profit improvement for a product with a 5% margin.

EXHIBIT 1: Teams can use dynamic deal scoring to get recommendations on discounting levels

Custom front-end for each client and designed with ease-of-use for adoption

Economics summary

Peer and deal benchmarking using Deal Advisor proprietary methodology

Workflow ensures guidelines are applied and exceptions managed

Data is captured in central database and can be analyzed with Performance Vision, Price Advisor

The screenshot displays the Periscope software interface for deal configuration. At the top, the navigation bar includes 'Deal Launchpad', 'My Dashboard', 'Customer Insights', 'Configure', 'Price', and 'Quote'. The deal ID is 51001131554, and the status is 'Rejected'. The interface is divided into several sections:

- ACCOUNT SELECTION:** Shows Business Unit (Joins), Account Name (Newwag Med Center), State (PA), Top 200, and Peer Group (3).
- POCKET PRICE WATERFALL:** A bar chart showing the progression from List Price (\$54,572) to Final Price (\$38,700). Key components include Item Level Discount (\$10,158), Deal Level Discount (\$2,720), Net Sales (\$41,688), Rebate (\$2,720), Standard Payment (\$175), and Override Payment (\$80).
- DEAL PERFORMANCE:** A histogram showing the number of deals versus discount levels. A red arrow points to the current deal's position, with a callout stating 'Good deal' and '27% similar deals were better'.
- APPROVAL TRACKER:** A horizontal bar chart showing the approval process. The current deal is at the 'Sales Manager' level, with 'Sales Rep' at 25%, 'Sales Director' at 50%, and 'Sales VP' at 75%.
- DEAL OVERVIEW (Right Panel):** A summary table showing:

Total List price	\$54,572.40
Item Level Discount	18%
Deal Level Discount	5%
Net Sales	\$41,687.65
Margin%	33%
Other Charges	\$780.00
Grand Total	\$42,467.65
Rebates	5%
Your commission	\$1,527.27

High-end wood flooring manufacturer

A manufacturer was facing a one-two punch: competitors willing to accept low margins and an increasingly consolidated customer base demanding lower prices.

Two work streams – in deal- and value-based pricing – helped the sales team exceed ROS improvement targets of 2-3%.

After developing a margin waterfall based on revenue and cost elements at the line-item level gathered from more than 20 sources, the company used an automated business-rule approach to generate more than 800 commercial actions at a customer and product level.

This whole process took only 6 weeks.

In the test country market, ROS rose 4%, leading the Head of Sales to promise a 25% EBITDA improvement for the following year. With a pricing excellence road map in hand and seven change initiatives in the works, the company has a long-term plan for additional improvements.

Building a fact base for richer discussions with customers

Although many procurement teams place a huge emphasis on price, they may also have to consider product availability, the supplier's brand and reputation, and the unique services it offers, such as hands-on expertise, guaranteed delivery, or full refunds for unused products.

That's why one of the four levers, which we call "dynamic deal scoring," is so powerful. It can consider dozens of factors, from industry vertical to salesperson tenure and the product features each customer values most, even among products that might seem indistinguishable. Sophisticated analytics algorithms determine which of those explanatory variables have statistical merit and should actually drive discounting. (The optimal pricing algorithm can extend to eCommerce, since customers generally have to provide their credentials and identify themselves to see prices online.)

The algorithms also reveal the range of discounts in comparable deals over the past year or two, including the prices offered by top-performing teams. This gives salespeople a clearer idea of what a good price looks like in each situation – and the confidence to aim high. Since most salespeople are competitive, they don't want to make a deal that's less profitable than similar deals made by their peers. The insights coming out of deal scoring can also serve as a basis to calculate incentives, e.g., rewarding sales reps who quote most of their deals in the “green” zone.

All of the insights that emerge from the process can be explained in plain language, and they aren't meant to replace the judgment or wisdom of the sales rep. Instead, they reveal best practices and opportunities based on the history of the customer relationship and other salient factors. They can also reveal which deals could destroy value, helping managers determine whether to change the terms or walk away.

Making the most of these insights requires superior execution – which looks different at each company. We have found that the most successful pricing teams test approaches in an iterative way, refine those approaches and their tools based on feedback and impact, and use some of the resulting financial gains to fund the next steps of the journey, including additional data, new tools, and expert support.

Sophisticated algorithms can consider dozens of factors among pricing and reveal the range of discounts in comparable deals.

Manufacturing company

Our client, with more than a billion euros in sales and 200,000 SKUs, needed to improve profitability to boost shareholder value and fund new investments.

Two teams worked in parallel to “set the price” and “get the prices.” The price-setting team developed an automated, rule-based methodology and evaluated the company's competitive price positioning. The other team developed a simple quotation tool based on dynamic deal scoring to give sales teams fresh insights into deal margins. The team evaluated discount and margin variance and identified easy-to-implement “quick wins” – some that began delivering margin improvement even before the diagnostic was complete.

The team identified opportunities for 3-4% in ROS improvement, more than half of which was delivered in the test country in 12 weeks.

The years ahead

Although digital tools will keep getting more powerful on both sides of the negotiating table, some of the fundamentals won't change. It will always be easier for a buyer to ask for a discount than for a seller to ask for a price increase, for example. Sellers will never know in advance if a customer will accept a price – or if they could've gotten a little more.

But sales teams that use a scientific, step-by-step approach play their hands better and deliver more profit in the long run. As powerful as these approaches are now, they'll only get better as the software becomes more sophisticated and computer processing gets faster. For example, we expect multi-linear regression models to reveal underlying price drivers and algorithms to provide sales teams with powerful new insights into the next best offer and next product to buy.

The companies that learn to use the new tools will be more profitable, which will allow them to make larger investments in additional advances and create increasingly large advantages over their slower-moving competitors. Indeed, we expect some smaller players to use science to find new pricing opportunities and gain ground against much larger incumbents. Those who can't keep pace will eventually lose their seats at the negotiating table.

About Periscope®

Founded in 2007, the Periscope® By McKinsey platform combines world-leading intellectual property, prescriptive analytics, and cloud-based tools with expert support and training. It's a unique combination that drives revenue growth, both now and into the future. The platform offers a suite of Marketing & Sales solutions that accelerate and sustain commercial transformation for businesses.

The company leverages its world-leading IP (especially from McKinsey but also other partners) and best-in-class technology to enable transparency into big data, actionable insights, and new ways of working that drive lasting performance improvement and a sustainable 2-7% increase in return on sales (ROS). With a truly global reach, the portfolio of solutions comprises of: Insight Solutions, Marketing Solutions, Customer Experience Solutions, Category Solutions, Pricing Solutions, Performance Solutions, and Sales Solutions. These are complemented by ongoing client service and custom capability-building programs.

To learn more about how Periscope's solutions and experts are helping businesses continually drive better performance, visit www.periscope-solutions.com.

