Combat Inflation with Advanced Pricing Tactics

A guide to Install and Exploit Essential Pricing Solutions

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Unprecedented inflation, geopolitical tensions and material shortages are putting pressure on industrial companies to manage their pricing functions with speed, discipline and precision. This can be overwhelming, especially for organizations that are not so mature or have not prioritized pricing. Fortunately, there are methods to fast-track the installation of pricing tools, measures and processes to improve pricing effectiveness and to limit P&L deterioration. Advanced Analytics and Tactical Pricing form the cornerstones of this approach.

2020 and 2021 were whirlwind years for the industry and organizations once again look at another year full of uncertainty, which are triggered by extraneous events such as the ongoing COVID-19 pandemic and Russia's invasion of Ukraine. Soaring demand, accellerated by surplus of cash, commodity shortages by production and supply-side disruptions as well as skyrocketing energy prices have turned inflation into one of the biggest deterrents to growth.

The impact is especially severe for manufacturers with a high percentage of costs coming from commodities, production and delivery. While for now variable costs are most affected, fixed costs (e.g. labour, rents) may follow soon. Without an end in sight, companies are torn between passing on price hikes to their customers or absorbing huge margin losses themselves.

In such disruptive times, a strong tactical pricing or margin management function can be instrumental in helping companies stay afloat. This review explains how companies can install solutions that fast-track pricing capability developments, restore commercial control, increase pricing agility and make them more resilient.

To install a Pricing function that is lean and fitting for the organisation, there are three questions that business leaders must consider:

1. *What information and insights are needed to support decision making?*

2. *How should we organise ourselves?*

3. *What should we steer on and how?*

REQUIRED INSIGHTS ON THE BUY, BUILD & SELL SIDE

Insight Into Procurement and Supply Trends

Commodity supply markets are volatile, but the ability to predict input cost trends can give organizations an edge in negotiations with suppliers and customers. Moreover, it allows to identify parts of the product portfolio that are most affected (Refer to Deep-dive 1). AI-models are advanced in simulating (via Markov Chain Monte Carlo models) and predicting demand and price effects (by Reinforcement learning) in supply chains and show tremendous benefits. While black swan events can hamper efficacy of models, it is sufficient to understand the timing and direction of input-cost fluctuations rather than the exact value of increase/decrease. Why? Simply because the cost of slow response is higher than that of acting too late.

Insight Into Proposition Differentiation

Not all offerings are created equal or equally appreciated by customers. As a result, they command different degrees of pricing power in the market. It is essential to understand these drivers of power to be able to assess the true nature of a proposition (Refer to deep-dive 2) to be able to apply differentiated pricing and negotiation tactics. Is it a specialty, commodity or growth product? This determines the choice of the pricing methodology from value-based pricing to cost+, competitive pricing (See deep dive 3). Advanced analytics and AI solutions, like cluster-wise price elasticity models, offer nearly plug-and-play solutions to reveal this distinction and help set prices (Refer to deep-dive 4).

Insight On Client Negotiations & Contracting

An understanding of the customer negotiation behavior and business needs is essential. The first step is to review existing contract structures, and in particular the flexibility of passing on price corrections. Furthermore, it is important to understand the differences in customer context, willingness-to-pay (see deep dive 5) and negotiation levers, such as customer lifetime value, locked and free volumes or churn risk (Refer to Deep-dive 6) as well as the true nature of a customer relationship, based on Kraljic models. Finally, it is critical to have deep insights into these accounts and train sales on (large) account negotiation tactics.

To support fast and accurate decision making, forward-looking trends from the supply market need to be combined with insights on the product proposition and customer attributes.

THE BEST WAYS TO GET ORGANIZED

Most organizations operate in matrix structures with pricing at the crossroads where product offering and sales execution meet. The "ownership" of the product portfolio and price positioning lies with business/product/category management, whilst Sales operates as the "owner" of the customer base and executes negotiations and contracting. It is here at this cusp where the opportunity lies to get tactical pricing organized, ready to direct pricing execution on short term.

Review the Pricing Org. Structure
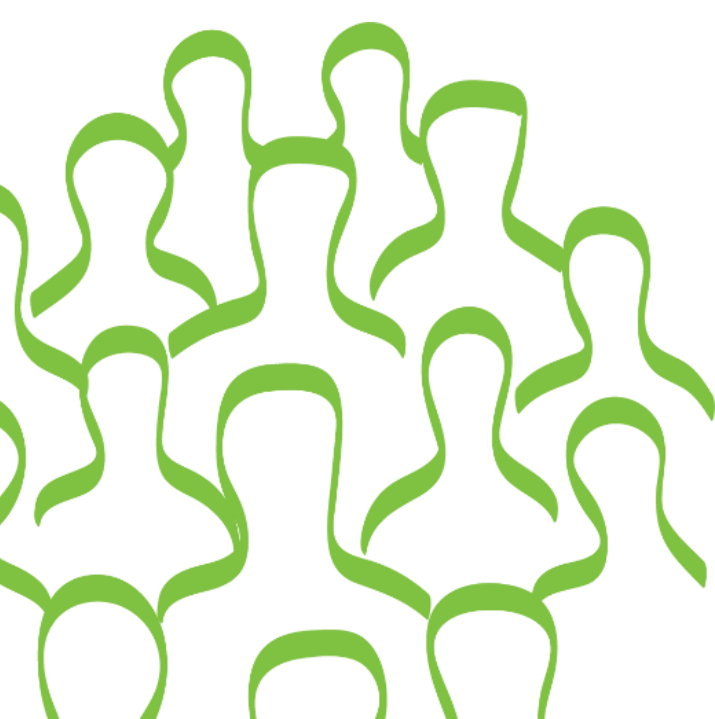
The first step is to take stock of the current price setting and price getting roles in the organization. Does pricing take place in formalized roles and meetings? Are price discussions triggered by contract renewals or new negotiations? How are price reviews and margin management performed? Often, the structures needed to install tactical pricing and margin management already exist but are not correctly configured or utilized but can be with minimal effort

Piggyback on IBP and S&OP Platforms

Integrated business planning and sales & operations planning have long been dealing with the complexity of reaching agreements across different functions (manufacturing, supply and demand, sales) to resolve tactical issues. Since the similarity to tactical pricing is high, companies therefore can simply add the tactical pricing agenda to the existing meeting structures in place.

Interventionist Pricing Control Towers

In organizations where operations, information and decision making are siloed, it is a good idea to install a Control Tower. Here a mandated/ empowered taskforce composed out of product management, sales, and if needed, demand and supply planning come together facilitated with data, analytics, scenario simulation capabilities, to analyze events, assess impact, simulate pathways and take decisions on topics such as how, when and how much price increases/decreases to pass on to customers.

Most organization have the fundamental structures needed to organize tactical pricing but do not organize themselves correctly or utilize these structures effectively.

SIDEBAR – DOES THIS APPLY TO MY ORGANIZATION?

It may be fair to question what of the above is relevant to your organization. The industry in which you operate will most likely determine the relevant parameters affecting your business. We recommend to carefully assess the pricing waterfall and to define where impact is made in your business system. Looking at examples at the extremes:

- Industrial intermediates, like fine/specialty chemicals as well as the food and pharma ingredient industry, operate on high capital-intensive assets that generate intermediates (output) that are deeply integrated into the manufacturing process and value chains of the customers they serve. These companies typically have a relatively small number of customers, a high percentage of YoY retention sales, negotiations are face to face and the human component is very dominant. Commercial control and strong sales guidance are essential while systems and tooling play a supporting role in sales execution.

- FMCG, Wholesale and Industrial finished goods, on the other hand, typically have many products and customers and pricing impact is seen taking place by decisions more "upstream" in the process. Product or category manager set (differentiated) product price lists and craft discount/proposition structures for different segments. These companies sit on a treasure-trove of data and can highly benefit from using AI-driven dynamic (portfolio) price setting which then has to be uploaded and maintained in systems, which are critical to governing pricing.

STEERING PRICING TO MEET BUSINESS OBJECTIVES

Pricing is sometimes used as an umbrella term for all the price-related activities that take place within an organization. There are different levels of pricing, however. At the outset, there is strategic pricing, which focuses on brand positioning, portfolio, product line positioning and makes use of price bands and discounts. At the other end of the spectrum, we find operational pricing, which encompasses the plain execution of pricing guidance by sales and marketing. Tactical pricing is often neglected but arguably the most essential– especially when it comes to passing on inflation or dealing with volatility. Tactical pricing bridges the gap between the strategic and operational levels. It is about determining tactics on customer groups or segments on a short to medium time frame and addressing market/competitor cues. Tactical pricing dictates how to deploy differentiated pricing tactics towards customers as well as ensure pricing and margin compliance, governance and control. The key success factors of tactical pricing are

Objective Setting & Governance

It is essential to steer sales execution based on tactical parameters (for example an x% input cost-hike, margin leakage from low-price outliers, churn risk and market upsell/cross-sell potential). Sales management and product line management should have a handshake agreement about the objectives and monitor compliance.

Differentiated & Dynamic Deal Price Optimization

Flat price increases are blunt instruments. Input-cost price hikes must be identified and connected to both the product and the customer portfolio. The next step is drafting clear price instructions, dynamically defined, for sales to execute towards the customers. To maximize deal value, sales can be enabled with deal optimization insights (customer willingness to pay, product price elasticity, attrition risk, volume upsell and cross-sell potential). This creates a more individualized deal guidance per stock keeping unit per customer.

Cost to Serve, Contract Terms & Surcharging

Transparency on a customer's true pocket margin, after factoring in leakages from freight, samples, servicing and marketing costs, is critical for sales. Similarly, it is not enough to define differentiated service levels on the basis of cost drivers and value impact for the customer. Indeed, it is more essential than ever to adhere to these different service levels and monitor their execution, especially when it comes to top cost drivers like minimum order quantity, standard order frequency and consignment stocking. Leakage outliers should be cleaned up regularly

Tactical Pricing is arguably the most effective tool in dealing with volatility and to achieve objectives around margin recovery or growth.

CONCLUSIONS

In today's turbulent economic environment, agility and precision in pricing can make the difference for companies, especially in commodity and other dynamic sectors. The time is now for business leaders to optimize their companies' pricing practices by taking advantage of the latest pricing expertise and technology. Out of the wide space of "Pricing" two elements can be lifted to expedite successful implementation of crucial measures to counter margin erosion: Installing a tactical pricing function and apply Advanced Analytics.

HOW CAN DELOITTE HELP
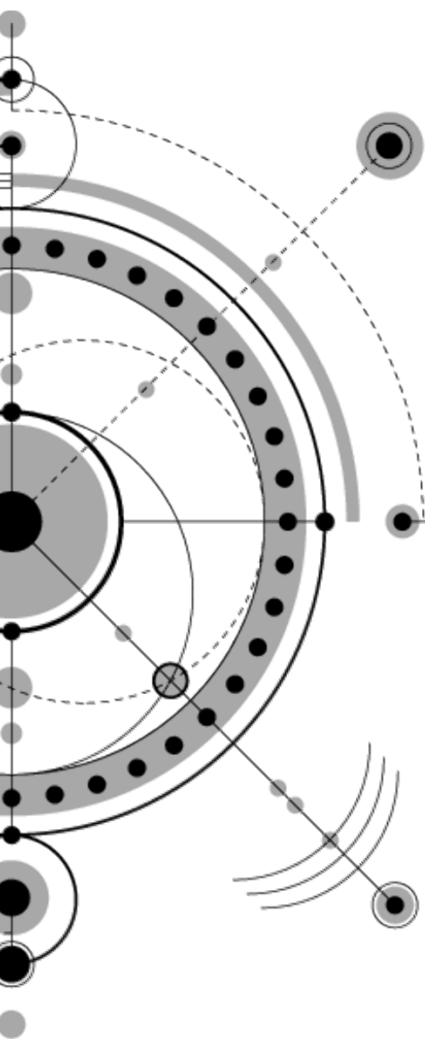
Frontline Profitability Analysis. A online 360 self-assessment on all aspects of pricing filled out by key pricing stakeholders can deliver a detailed pricing maturity mapping of your organization on a strategic, tactical operational and enabler level. Providing full insight in how to roadmap pricing capability development.

PriceCypher. The AI-driven industrial dynamic pricing solution that is bundling all essential and actionable insights on dynamic pricing, portfolio pricing and deal-optimization, to sales in any desired system (ERP, CRM, CPQ, Excel). Without system implementations, full transparency is created on portfolio pricing down to deal pricing.

Value Recovery Campaigns, are the most very effective approaches in crafting and effectuating pricing capability in your organization. It is entailing strategy, tactics, digital, technology, operational and change components with full focus on execution at deal level and with immediate effect on your profit and loss.

DEEP-DIVES

Deep Dive 1: Raw Material Forecasting for improved Deal-win Probability

In the case of an event, an **Event Model** is triggered which takes over the forecasting till the event/disruption subsides.

Graph 1: The graph is showing the actual price performance that suffered both incident bases price corrections as market based price corrections. Multiple models are activated to each situation to run analysis for RM price predictions.
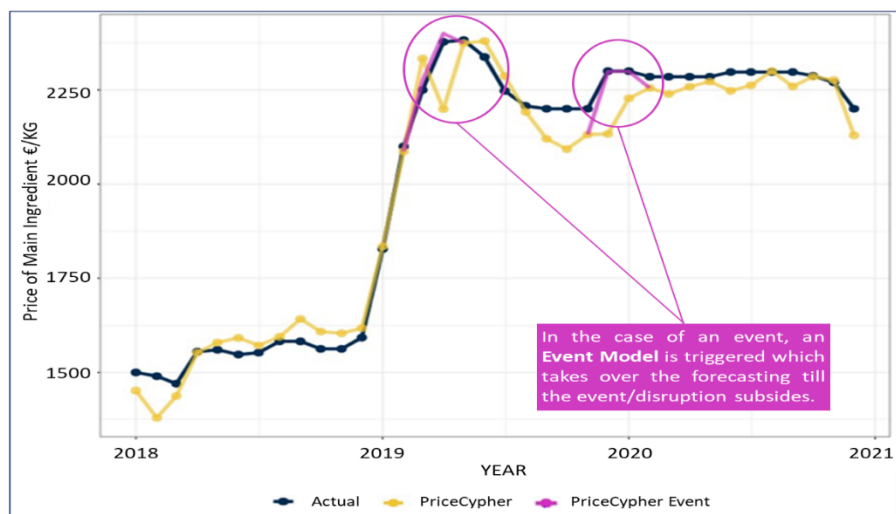
AI enabled models can provide visibility into cost trends of base commodities through AI enabled models. This allows you to:

- identify effected product lines and indicate the need to pass on increases in raw material prices to customers swiftly

- exploit price trends of materials earlier in the value chain

- prepare for black swan events by incorporating Event Modelling

Deep Dive 2: Pricing Power Assessment of the Product Portfolio

Assessing a product on multiple domains such as Maturity, Risk, Purchase Power, & Ability to Compete makes it possible to determine its Pricing Power.

This Pricing Power is combined with historical sales data to compare the planned selling price with the actual realized selling price to ensure products are line with their innate attributes.
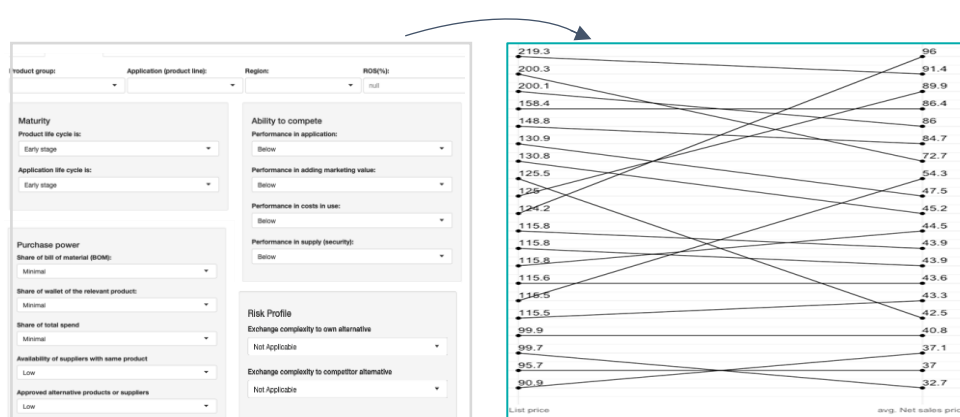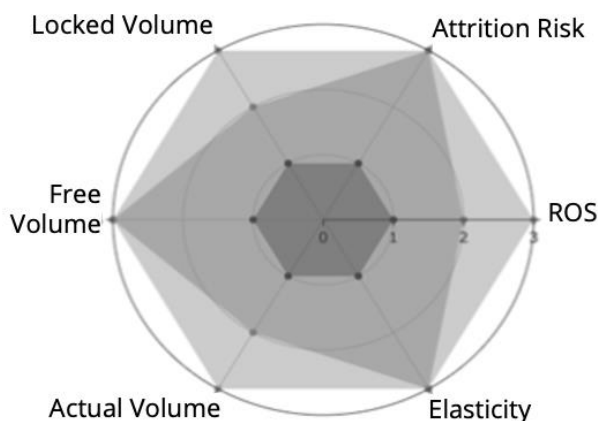

Graph 2: The Pricing Power assessment is resulting in a challenge to the existing price positions of the portfolio (left graph) indicating the incorrect base price positioning of brands in the portfolio, which can be confirmed by evaluating the relative position of the sales price compared to their list price (right graph).

DEEP-DIVES

Deep Dive 3: Price Sensitivity analysis

Elasticity of products can be deduced by using historical price-volume trends (i.e. how the customer volumes respond to changes in price).

Elasticity metrics are important indicators in multiple ways and can be used to segment the portfolio (Specialized, non-elastic vs commoditized, elastic).

Graph 3: The spider is providing insight in deviations on key business parameters from the P&L and revealing the improvement potential of full or selected business parts.

This enables differentiation in pricing, discount and promotions policies for different portfolio parts and also exploit the power of free and locked volumes.

Deep Dive 4: Setting & Maintaining Product List & Floor Prices

Unclear guidelines on pricing, can lead to sales giving excessive discounts impacting net prices becoming fragmented and scattered.

Basic pricing guidelines provide a list and floor price, to set boundaries within which sales should operate during negotiations.
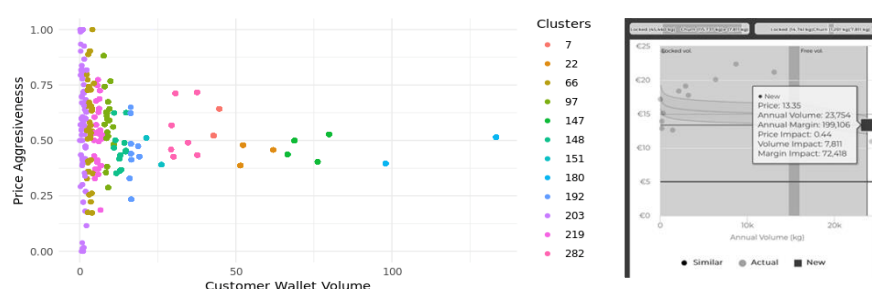
Setting and maintaining these price bands can be done using data and analytics and is based on desired pricing strategies (e.g. value based, cost+ and competitive).
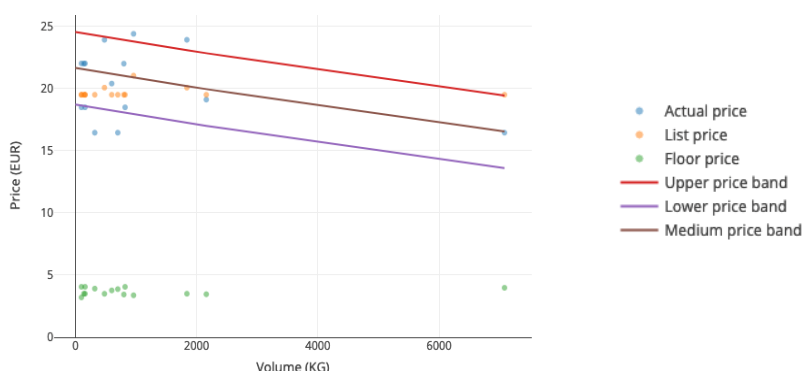
Graph 4: The scatter plot indicates the price volume positions of customers buying the same product. By combining data derived customer behavior, relations can be connected to the generic product price profiles and hence generating price bands.

DEEP-DIVES

Deep Dive 5: Capture willingness-to-pay to clean up outliers

Price outliers can be cleaned up using risk-averse methods.

Peer-based reference pricing identifies customer willingness-to-pay and provide an optimum price for customer-product combinations in the portfolio.

Graph 5: The scatter plot is highlighting the "business compartments" with high correlation on detected and similar price drivers such as volume, loyalty, price aggressiveness to changes as well as classical market and customer segments. It allows tools like PriceCypher® to lift out a predictive price to each customer-product combination on the highest granular level, visualized directly to sales.

AI & ML models generate the optimum between margin and volume to achieve different objectives per business line, product or customer segment.

Deep Dive 6: Predicting customer churn

Customers at risk of leaving can be identified by analyzing historical price, volume, customer relationship information, won-loss and external market data.

By using historical patterns on customer loyalty, customers can be identified with a high likelihood of churn.

Each indicator creates an opportunity to prevent churn. Especially at times of passing on price hikes, it is important to make sure that other factors, such as poor service levels, do not increase churn.
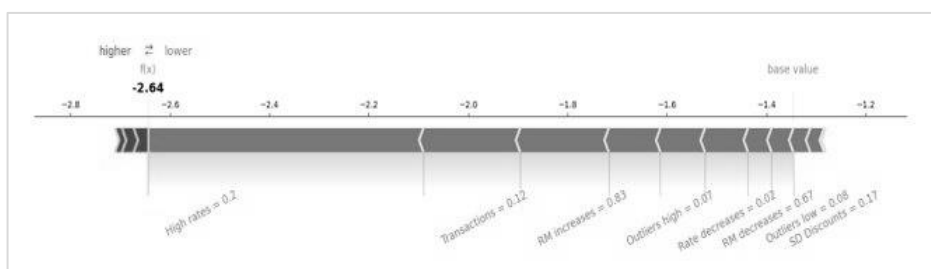
Graph 6: The bar chart is providing the quantitative value ranking of competitive attributes of the proposition and calculating the churn factor to individual customers.

Let's Talk.

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