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Unlocking hidden margin:
Why wholesale distributors must take special pricing agreements seriously

Why SPAs are so important in Electrical Distribution

Special Pricing Agreements (SPAs) are a vital component to an electrical distributor's business and overall profitability, not just a back-office nuisance. In this whitepaper, we outline:

1. Why SPAs are so important in Electrical Distribution
2. What makes SPAs so complex
3. Why today's SPA management practices are inadequate
4. The multitude of SPA leakage drivers that result
5. What "best-in-class" looks like for SPA Management

The bottom line: SPAs are complex, here to stay, and represent a significant opportunity area for many electrical distributors.

By using SPAs, pricing can be tailored in ways no single alternative can replicate. **Distributors** can prioritize specific customers and/or territories with hyper-targeted pricing to improve margins or drive incremental volume.

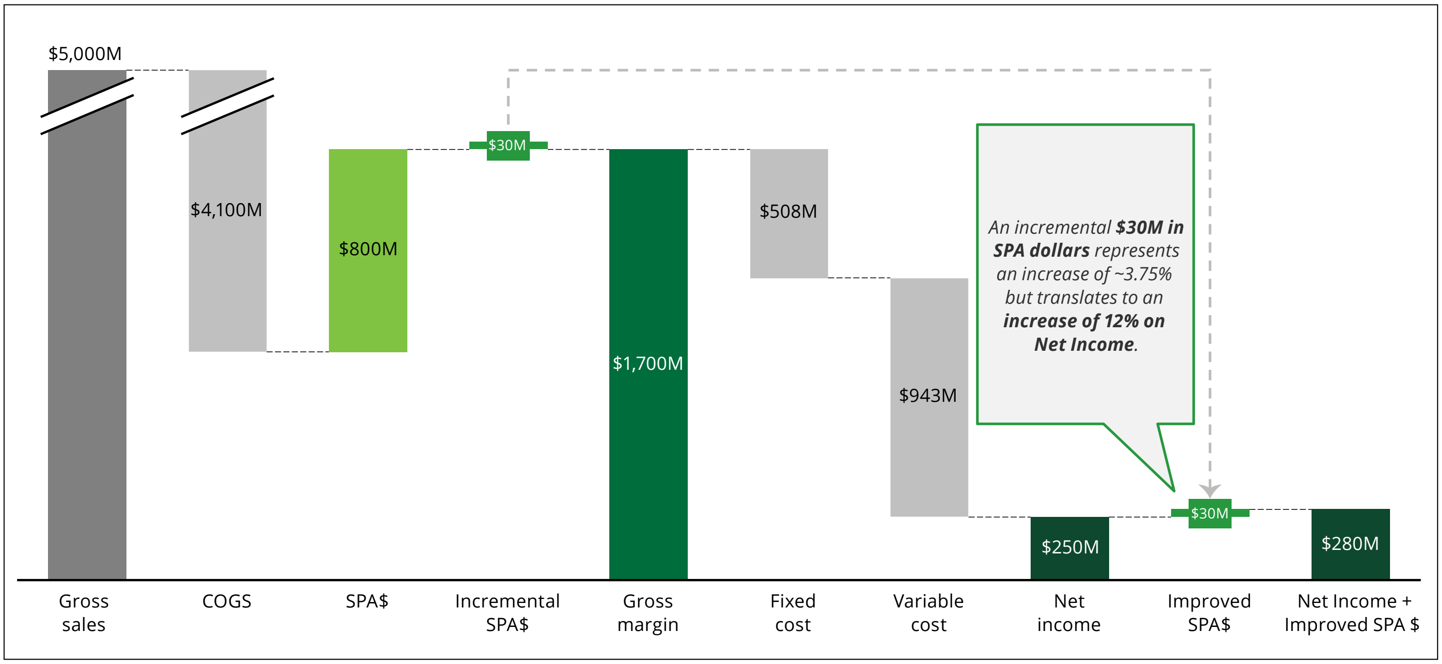
Manufacturers directly benefit from SPAs as well. When used, **manufacturers** disintermediate distributors and gain strategic pricing control directly to end customers. Further, it allows manufacturers to maintain advantageous sell prices to distributors for non-SPA customers.

Large and growing **customers** benefit by receiving advantageous pricing reflective of the value they bring to manufacturers and distributors.

Because of the advantages SPAs offer, they are heavily used. In fact, SPA dollars for an electrical distributor are often larger than net income dollars. Tackling SPA management opportunities presents both a fast time-to-value and a strong ROI relative to the effort required.

Consider a mid-sized electrical distributor, for example. This company may have ~$5B in revenue and ~$800M in SPA income. There is likely an opportunity to improve SPA income by 3-4% (~$30M). This will carry significant impact on net income:

Figure 1: SPA Opportunity Estimate for a $5B Distributor



What makes SPAs so complex

SPAs are inherently complex for multiple reasons:

- **Multiple SPA types:** Several SPA types exist including customer, market, special project (and more), each presenting specific requirements for distributor processes and technology systems
- **Number of agreements:** The localized nature of SPAs can lead to tens of thousands of different contracts set up by thousands of associates, each with their own preferred way of structuring agreements
- **SPA Discount type:** Not all SPAs are designed with the same approach to reaching net cost. Some SPAs are discounted from the manufacturer's list price, while others may be discounted from into-stock cost. Additionally, SPAs can be designed using either a percentage-based discount *(15% off per unit)* or a raw-dollar discount *($4 off per unit)*
- **SPA renewal structure:** Suppliers manage SPA metadata differently and distributors must be able to manage these differences. Some vendors maintain the same SPA ID for years without change, while others frequently expire and re-issue SPAs under new ID numbers
- **SPA communication manner:** Suppliers vary in their technical maturity, meaning some may transmit SPA information through EDI (Electronic Data Interchange) while others may share SPA information via email or other manual means. Distributors must be able to accommodate a range of approaches

These traits of SPAs often make it difficult to understand the existing SPA landscape for a given manufacturer, even within the same sales branch. Organizations often leave sales reps to manage SPAs for their own books of business, leading to a wide range of results.

Why today's SPA management practices are inadequate

The complexity of SPAs necessitates robust SPA management to avoid financial leakage. Despite this, most distributors do not have adequate SPA management systems. Common gaps in SPA management systems are outlined below:

Table 1. Current State of SPA Management

People	Process	Technology
• SPA ownership duties span across pricing managers, sales reps, project specialists, back-office support, and regional managers with a lack of clarity on roles/responsibilities • Existing org structure does not enable the most capable resources to leverage their SPA negotiation impacts across geographies • SPA resources do not have the skillset needed to integrate large datasets and mine data for value capture opportunities (Artificial Intelligence, SQL, R, Python fluency) • Sales resources pass on SPA cost savings to customers even when there is no business need to do so (they are often averse to seeing higher margins than what they have historically earned)	• Information on leading practices is not shared and leveraged across the organization ("pockets of excellence") • Spend is rarely fully leveraged in negotiations • The required actions (proactive price preservation, margin pads, retroactive margin protection) to preserve margin are not adequately understood • There is often poor visibility on margin pass-through to customers after SPAs are improved	• Data is siloed across disparate systems (ERP, standalone SPA tools, flat files, unorganized contracts, business rules • Critical data integrations are lacking (master data for SPAs, SKUs, and customers; contract metadata; sales data; SPA claim accruals/rejections) • Software packages like Celerity, Epicor, and Vistex support some SPA Management execution and audit needs but lack standardized ways to address the complexities of the wholesale distribution space • These solutions do not focus on forward-looking SPA negotiation, market intelligence, or margin capture • Big data and AI are not being used for vendor negotiations or SPA leakages beyond basic dashboards and reports, despite the data being available. The speed-to-value these capabilities can unlock is often missing today

The multitude of SPA leakage drivers that result

When SPAs are not effectively managed, a distributor loses gross margin dollars in many distinct ways. Common drivers include:

Figure 2. SPA Leakage Drivers

Leakage Tree (Drivers + Definitions)

SPA Data Setup

Data Entry Errors

Manual SPA execution processes can result in a high-degree of manual entry required. This can naturally lead to leakage issues which vendor may not call out

Lock-Ins

Customer pricing (or billback amounts) on SPAs will sometimes get "locked in" to the system; changes to customer price going forward can drive SPA leakage

Buy/Sell Item Code Mismatch

Internal system issues may result in a disconnect in SKU codes of items bought and sold, even on the same item. This can lead to SPA execution issues

Cost/Price System Timings

Costing and Pricing systems may run on different cadences (e.g., weekly data refreshes), causing calculation and billback issues even when amounts are correct

Quote vs. Invoice Discrepancy

Vendor quotes distributor at a lower cost than what is ultimately loaded/executed

Exclusions

When SPAs are applied at a SKU-level instead of an item-hierarchy-level, certain items may mistakenly get excluded from accruals

Order vs Ship Date Costing

Misalignment between costing and pricing practices with regard to order/ship-date standards can cause a vendor to push back on bill back calculations

Execution of Expired SPAs

Distributor may not recognize a SPA has expired and continue to extend SPA pricing which will not be recoverable from vendor

Location Mismatch

Customer shipping location on the invoice is not covered by a SPA, but the customer shipping location on the sales order is, leading to a claim denial

System Capabilities

Multiple System Entry

While each individual system may have accuracy in calculations, poor integration points drive SPA execution issues

SPA Pricing Complexity

Vendor and customer strike a SPA pricing structure that is simply too complex for distributor's systems. Manual attempts to process drive cost and leakage

Overlapping SPAs/Rebates

Certain transactions may have multiple SPAs and rebates that apply. The right calculations must be executed to maximize eligible vendor income

Redistributor SPAs

Items are being purchased from redistributors which should still provide pass through SPAs, but they are not being executed/collected

Brackets

Customer is extended pricing through a SPA or Customer Agreement for a specific bracket, which may not align with operational practices

PO Updates Not Passed Through

Changes to POs with a vendor increase amount paid but are not recognized to re-calculate relevant billback amount

Vendor Driven

Customer-Vendor SPA Disputes

Customer and vendor reach an impasse over SPA details. The distributor extends beneficial pricing but doesn't collect rebates from vendor

Vendor SPA Rejections

Despite having a valid SPA agreement in place, the vendor rejects the SPA claim, and the distributor does not identify the agreement not being applied, hurting margins

Retroactive Agreements

After fixes to existing rebate/SPA agreements have been applied, retroactive money owed is not recognized and collected

Margin Passthrough

SPA Benefit Passthrough

Net cost improvements are secured with vendors, but incremental margin is not preserved as cost improvements are passed through to the customer

Low Margin Transactions

Items are continually sold at low or negative gross margin rates due to low/no SPAs (where deep SPAs would typically be expected)

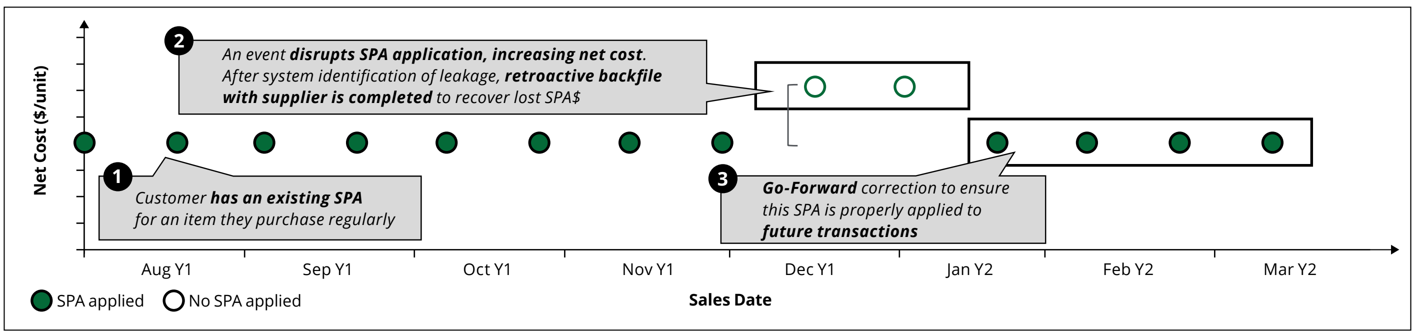
Below, two case studies walk through real-world examples of how these 20+ leakage drivers can be managed:

Case Study 1: Execution of Expired SPAs

Execution of Expired SPAs

- A large customer had a SPA for maintenance items they purchased regularly
- Outside the distributor's awareness, this SPA expired, and the customer's net cost increased by 20% on this item
  - » Without the right algorithms in place, this margin leakage would have continued indefinitely unless the distributor noticed this change
- However, by combining customer, item, SPA, and transaction data into a technology solution monitoring for these occurrences, this was flagged and raised with distributor team members for immediate correction with the vendor
- This led to over $8.6K in future cost savings and, because this 'always-on' algorithm caught this within days, $1.2K in one-time retroactive payments were secured

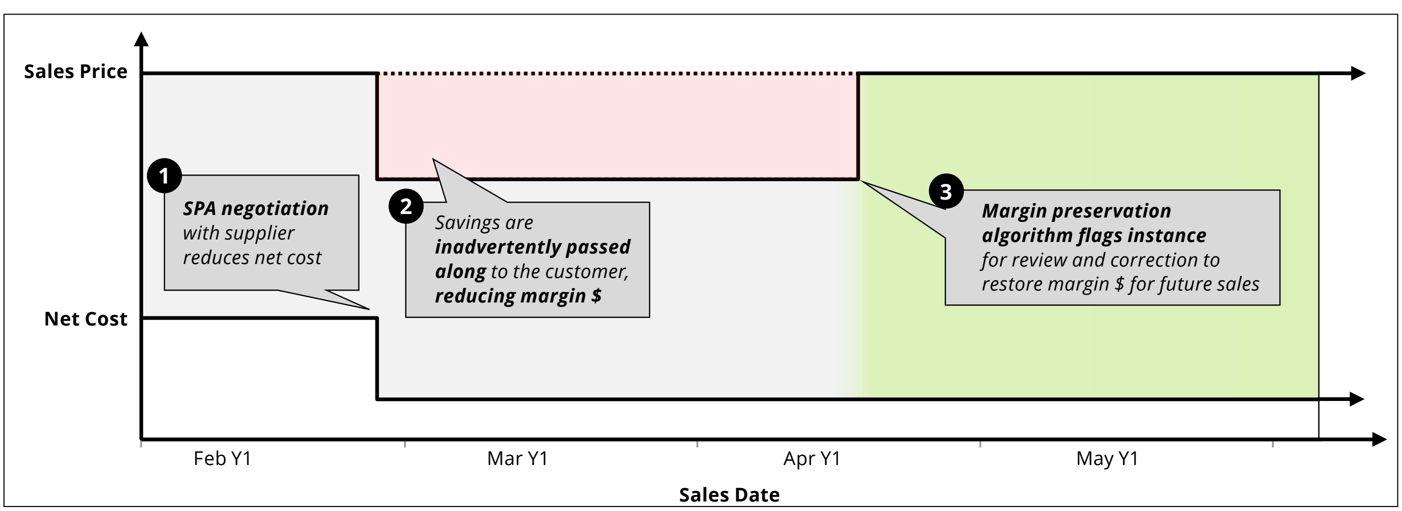
Without the right analytics tools in place monitoring transactions for these pattern deviations, distributors can forfeit significant margins without realizing it.



Case Study 2: SPA Benefit Passthrough

SPA Benefit Passthrough

- The distributor negotiated an improved discount rate on a heavily used SPA
- Cost-plus pricing was in place for the items on this SPA
- By failing to update the pricing rules after the negotiation, the distributor inadvertently passed along all negotiated savings (and more) to the end customer
  - » Due to the cost-plus pricing, the distributor made fewer gross margin dollars per unit after this took effect
- Fortunately, the margin preservation algorithm flagged this instance for immediate review
- Client counterparts confirmed the lack of pricing action was a mistake and took action to correct this in pricing setup systems
  - » This restored per unit margin on a negotiation win with over $100K in margin potential



What “best-in-class” looks like for SPA Management

Reaching “best-in-class” requires investment and consistent dedication across people, process, and technology. Distributors that lead in SPA Management tend to do most, or all, of the practices below:

Negotiations processes:

1. SPA ownership is centralized in a dedicated team with national authority while sales reps still have the autonomy to use SPAs to win new business
2. SPA owners have established recurring cadences with strategic suppliers (at least 2x per year) to improve and simplify SPAs across geographies
3. A broader scope of spend is leveraged when negotiating with suppliers, including collaboration with Category Management to prioritize growth vendors and categories
4. Post-negotiation pricing actions are strictly enforced to limit passthrough of margin gains only with exceptions for predetermined areas of strategic volume growth

Leakage processes:

5. Tailored algorithms for leakage drivers are implemented to promote rapid identification and closeout of leakage
6. A dedicated team is in place focused full-time on recovering missed SPA dollars

Enabling technology and analytics for the organization:

7. Data sources across ERP, products, and customers are brought together into a single SPA platform to identify forward-looking opportunities (ranging from ‘quick wins’ to region-wide SPA improvements)
8. Customer profitability is monitored using transaction data at the line-item level to flag instances of missed value capture across the SPA lifecycle (new SPA creation, existing SPA negotiation, backward-looking leakage closeout)
9. Algorithms are continually deployed to identify areas where SPA management benefits are slowing (due to an increase in vendor pushback, decrease in available opportunities, etc.)

Leading companies are using always-on analytics to identify and action opportunities—both on the leakage and negotiation front. The two figures below help bring to life what such a platform could look like:

Figure 3. Example SPA Platform—Opportunities Overview

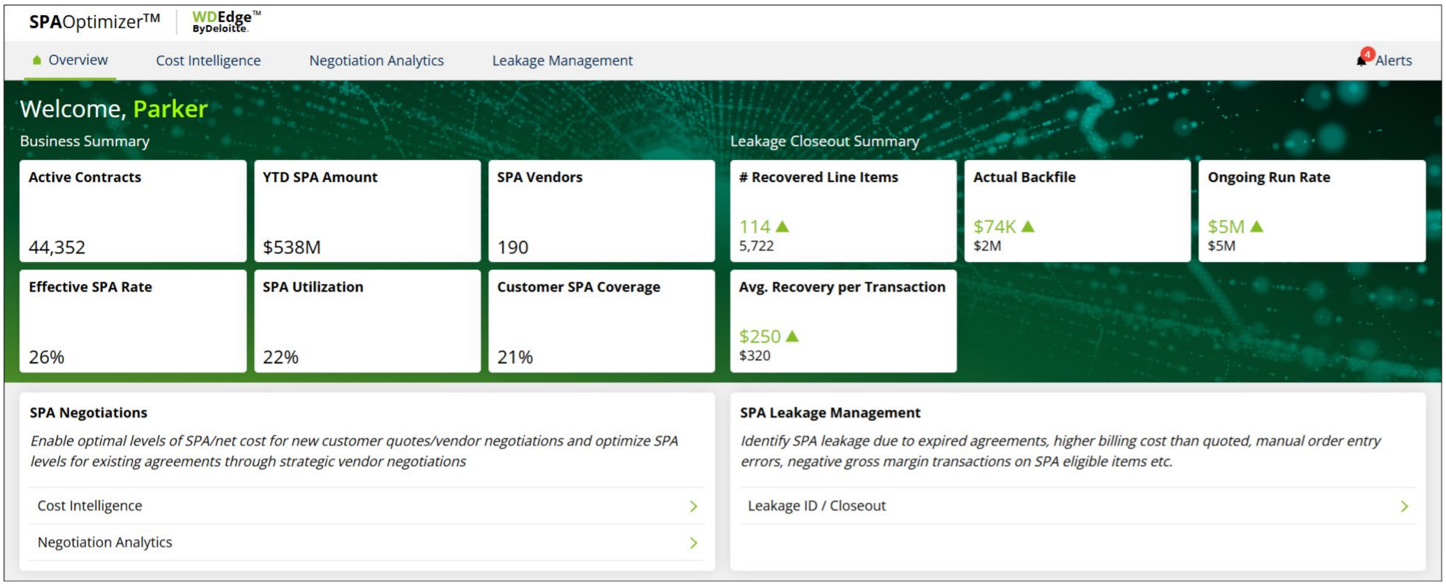
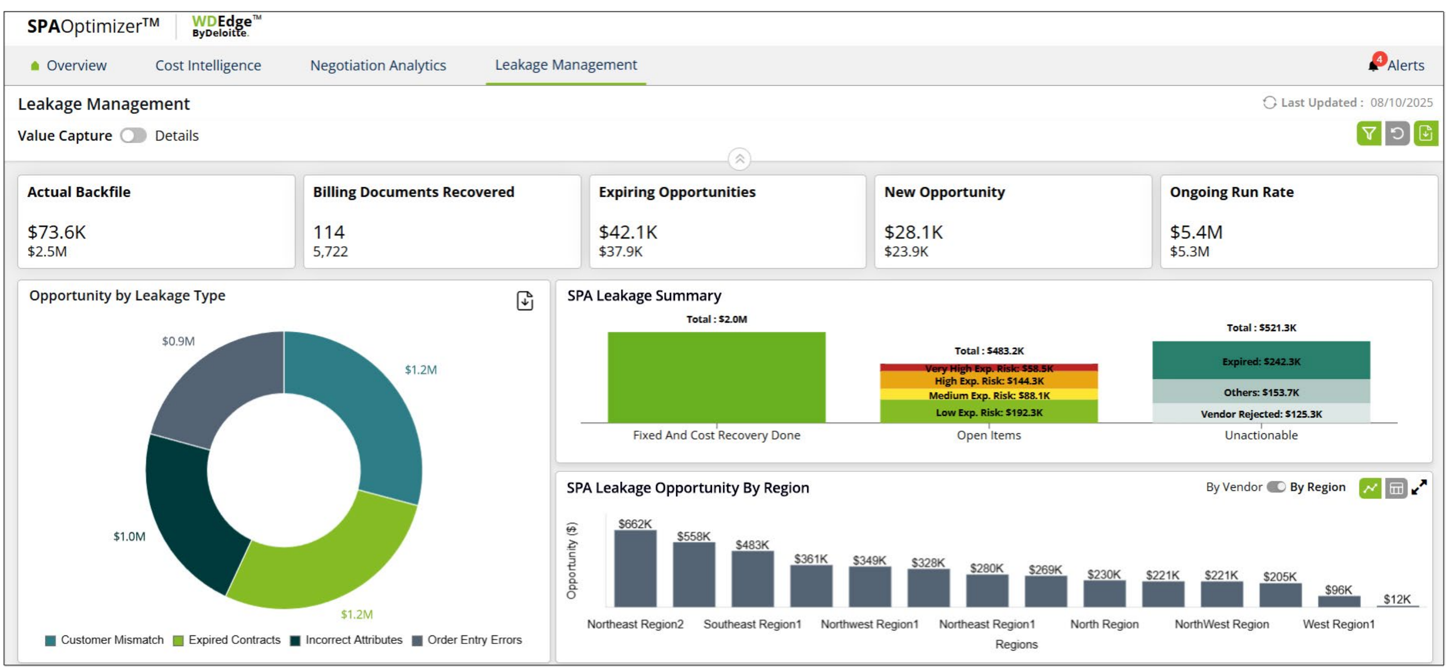


Figure 4. Example SPA Platform—Leakage Double-Click



Next steps

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Choosing to invest in improving SPA management and SPA administration capabilities can deliver strong ROI and unlock untapped sources of value for distributors. Interested in learning more? We would be happy to connect and talk through SPA opportunities with you and your team.

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