PRIVATE EQUITY PERFORMANCE IMPROVEMENT

Five Questions to Drive 5% Margin Improvement Through Pricing

B2B organizations often have an underdeveloped pricing function, resulting in margin loss (EBITDA) as well as undervaluation of the business. Yet, many business leaders think that pricing function is well established in their organizations and there may not be any further opportunity for improvement. So, why does this conundrum exist? Why do business leaders think they may not have a pricing opportunity, while in most cases, there potentially is one?

In our series, "Show Me the Money, But the Right Money Please!" A&M Private Equity Performance Improvement Managing Director, Cliff Hall, discussed the framework behind an effective commercial strategy that drives profitable sales, margin improvement, and cash flow. Our experience suggests that the reason behind the above conundrum lies in the answer to the following question.

"How do we know when the pricing lever is well explored or, what are the symptoms of an underdeveloped pricing function?" Business leaders or/and financial owners of B2B businesses should ask themselves the following key questions to explore margins improvements through pricing:

Q1 *Do you accurately track material and labor costs and are the cost changes accessible while bidding / quoting new opportunities? Do customer contracts prohibit cost increase pass through?*

Many organizations do not accurately track, ideally centrally, cost increases closely enough, and if even they do, many a time, customer contracts do not allow for frequent cost increase pass through, to cover for market volatilities, often resulting in margin leakage. While post-Covid19 many organizations have made some progress in this front, we still see gaps in many organizations we have worked with in the post-Covid19 era. This also warrants a close alignment between Pricing and Procurement functions, also a gap in many organizations.

Q2 *Do you employ a comprehensive customer segmentation model (not just based on customer size or order quantity) and a data-driven pricing engine that helps custom price each customer and product combination? If you use a cost+ model, do you usually apply a standard markup percent for bids or opportunities?*

Not all customers and products are treated the same and hence you need a custom approach to pricing that starts with understanding your customers. A segmentation model and a pricing engine, custom to your business, is vital in maximizing price setting in your organization. Otherwise, you will end up giving away the "consumer surplus". A vital part of establishing this capability is to have central and comprehensive master data.

Q3 *Do you track win/loss rates of new opportunities and renewals? Do you gather market intel regularly and not just depend on your salesforce for it?*

Most B2B businesses do not track win/loss and renewals data. Even if they do, insights from the data are not used in price setting (#2 above). Very high win rates could mean a potential pricing opportunity.

Regularly gathering customer feedback, the best intel regarding market prices comes from your best customers, and using those insights in your pricing strategy can drive renewals rates and new business.

Q4 *Are there appropriate performance metrics that are tracked regularly? And are the metrics aligned with sales incentives, and growth objectives?*

Performance metrics should be directly aligned with the growth objectives and sales incentives to drive the right behavior. These three dimensions should work in harmony to drive continuous improvement culture in your organization. Pricing performance metrics should track price deviation / discount from suggested price, at the customer, product, and rep-level. Price and margin performance metrics should be tracked and be an integral part of the regular (monthly / quarterly) reviews.

Q5 *Are there appropriate processes, business rhythm and governance in place to drive the change and the alignment between various functions for EBITDA improvement?*

In many organizations that we worked with, Procurement and Pricing don't work in tandem, Marketing and Sales don't see eye to eye, and the Finance department's involvement in pricing and governance is not impactful. All these functions should be in alignment, deliberately driven by culture and change management.

This means, leaders and boards of directors are holding their teams accountable for change, hiring the right talent, and balancing executive sponsor impact with resource alignment to drive changes quickly. This also calls for aligning initiatives with financial performance and metrics, to drive continuous improvement. Finally, as part of the culture change, this means frequent communication and celebrating small wins.

2-5%

TYPICAL MARGIN IMPROVEMENT RANGE THROUGH PRICING TRANSFORMATION

THE A&M DIFFERENCE

A recent client, a specialty steel manufacturer, thought they did not have any pricing issues. However, our team worked with the management and helped the client realize a ~6% increase in margins through pricing. Similarly, a large player in the Media industry also thought pricing is not a big lever for them, yet we were able to identify a 4% improvement in margin through pricing. A key component of success in the above engagements is running pricing pilots to gain small wins and gather momentum while managing risk in the business.

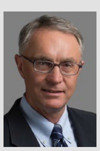
There are many other questions business leaders can ask to test potential price improvement opportunities, but the above five categories are most impactful, based on our experience.

Similarly, there are other levers, such as customer segmentation, sales organization structure, sales territory alignment, incentive design, customer success and retention, product rationalization, performance metrics etc., that can be explored to drive significant margin improvement.

We have successfully helped many P.E. portfolio companies, a few hundred million dollars in size to multibillions in annual revenue with pricing transformations across various B2B industries. Typical margin improvement ranges from 2 – 5% from pricing transformation. We would love the opportunity to collaborate with you too.

Contact Us

Learn more about how we can help you with the Pricing Strategy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