



MAXIMIZING ENTERPRISE VALUE BY OPTIMIZING CUSTOMER STRATIFICATION, PRODUCT SEGMENTATION, AND PRICING ARCHITECTURES

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May 2, 2017

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March 27, 2007

PAGE ONE

CHANGING THE FORMULA Seeking Perfect Prices, CEO Tears Up the Rules

Parker's Washkewicz
Weighs Market Power
Of 800,000 Parts

By TIMOTHY AEPPEL
March 27, 2007; Page A1

CLEVELAND -- In early 2001, shortly after Donald Washkewicz took over as chief executive of **Parker Hannifin Corp.**, he came to an unnerving conclusion. The big industrial-parts maker's pricing scheme was crazy.

For as long as anyone at the 89-year-old company could recall, Parker used the same simple formula to determine prices of its 800,000 parts -- from heat-resistant seals for jet engines to steel valves that hoist buckets on cherry pickers. Company managers would calculate how much it cost to make and deliver each product and add a flat percentage on top, usually aiming for about 35%. Many managers liked the method because it was straightforward and gave them broad authority to negotiate deals.



Donald E.
Washkewicz

But Mr. Washkewicz thought that Parker, which had revenues of \$9.4 billion last year, had stuck itself in a profit-margin rut. No matter how much a product improved, the company often ended up charging the same premium it would for a more standard item. And if the company found a way to make a product less expensively, it ultimately cut the product's price as well.

"I was actually losing sleep," recalls Mr. Washkewicz, a 56-year-old Cleveland native who started with the company when he was 22 and rose through its ranks as an engineer.

While touring the company's 225 facilities in 2001, Mr. Washkewicz had an epiphany: Parker had to stop thinking like a widget maker and start thinking like a retailer, determining prices by what a customer is willing to pay rather than what a product costs to make. Such "strategic" pricing schemes are used by many different industries. Airlines know they can get away charging more for a seat to Florida in January than in August.

Sports teams raise ticket prices if they're playing a well-known opponent. Why shouldn't Parker do the same, Mr. Washkewicz reasoned.

Today, the company says its new pricing approach boosted operating income by \$200 million since 2002. That helped Parker's net income soar to \$673 million last year from \$130 million in 2002. Now, the company's return on invested capital has risen from 7% in 2002 to 21% in 2006, putting it on the verge of moving into the top 25% of Mr. Washkewicz's list comparing Parker with "peer" industrial companies.

From the end of 2001 to present, Parker's shares have risen nearly 88% to about \$86, compared to a 25% gain in the S&P 500.

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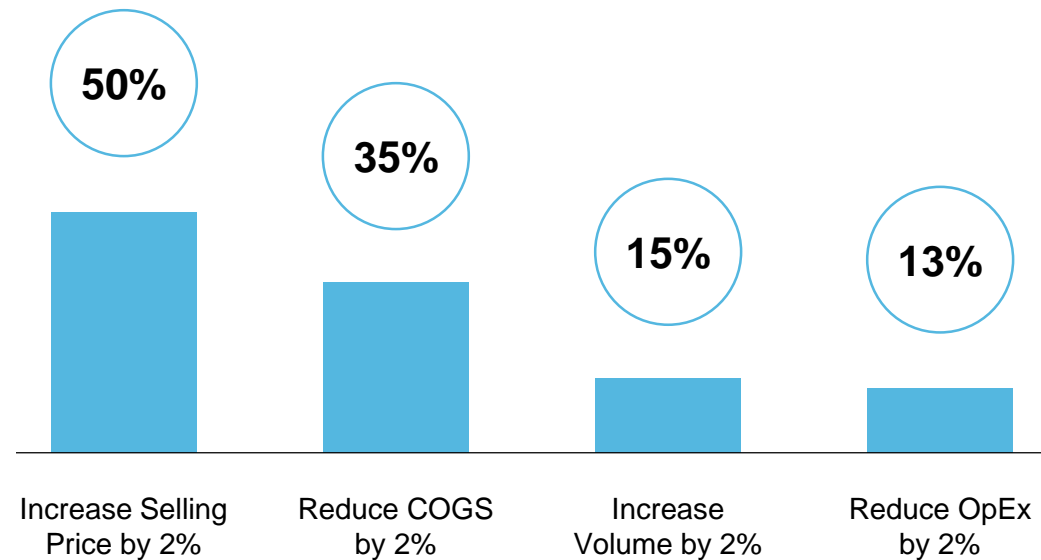
...boosted operating income by
\$200M

...net income soar to **\$673M** last
year from **\$130M**

...return on invested capital has risen
from **7%** to **21%**

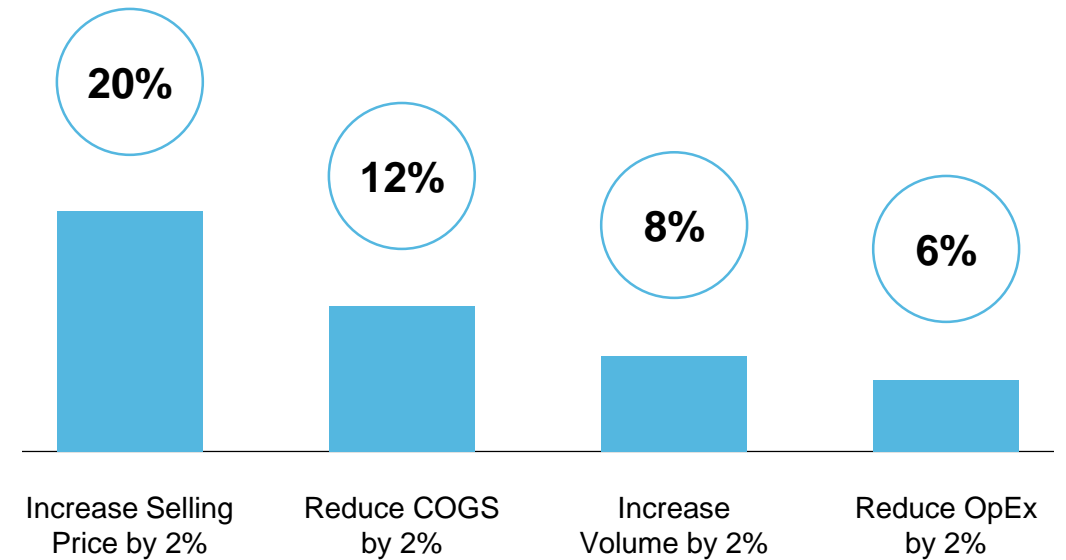
HOW PROFIT VARIABLES IMPACT OPERATING PROFIT

DISTRIBUTOR



Assumes 4% ROS, 30% Avg. GM, 26% Avg. SG&A

MANUFACTURER



Assumes 10% ROS, 40% Avg. GM, 30% Avg. SG&A

THE PRICING OUTCOME



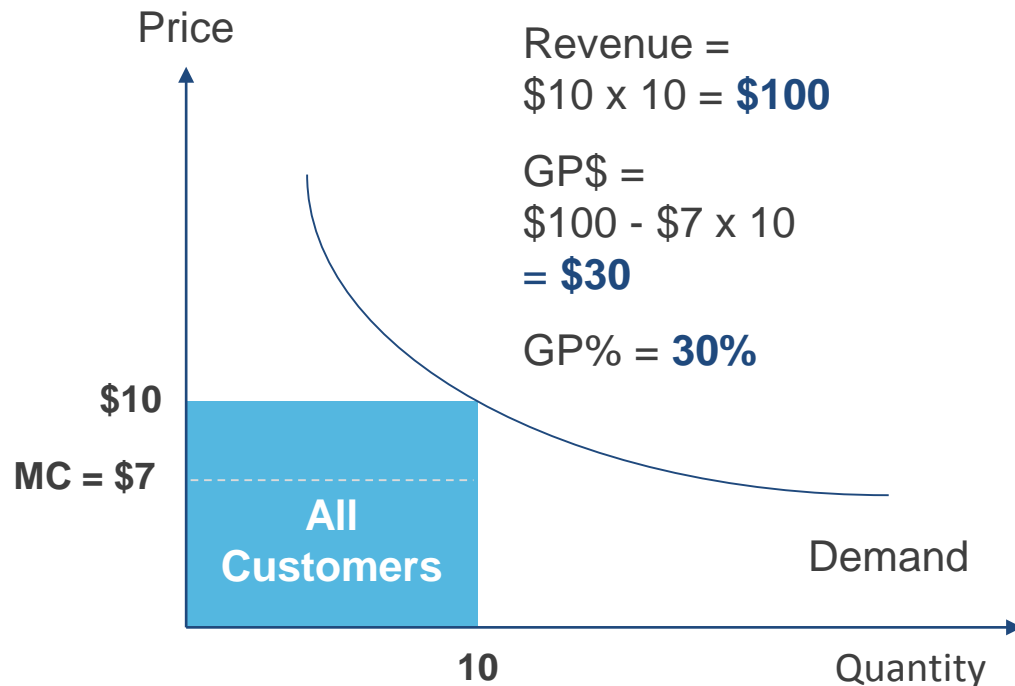
PRICING CHAOS:

- › Lack of tools and processes
 - › Guessing game
 - › Cost Plus Behavior
 - › Underpriced Customers
 - › Underpriced Products
- › Lack of Sales Force Training
 - › Negotiation
 - › Accountability, Metrics & Incentives
- › Lost Price and Profit
 - › 2-4% of Sales = 50% NAW Avg. EBITDA

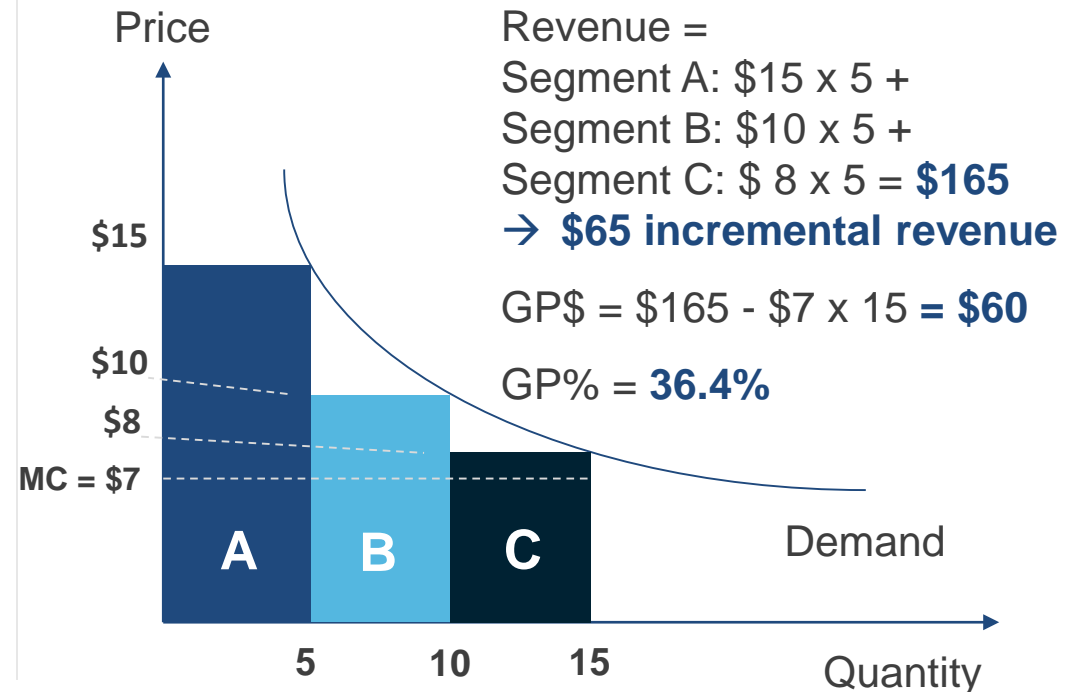
THE VALUE OF CUSTOMER STRATIFICATION

Customer stratification enables a more precise alignment of pricing strategy with willingness-to-pay, resulting in higher volumes and profits

1 price for all customers



3 prices for 3 distinct customer segments



DISTINGUISH CUSTOMER SETS WITH MEANINGFUL DIFFERENCES IN WILLINGNESS-TO-PAY



Possible dimensions of customer stratification:

- › Spend level (actual or potential)
- › Customer Type (e.g. Contractor, OEM, Reseller)
- › Cost-to-serve
- › Geography
- › Customer Sophistication/ Leverage



Levers for achieving a segmented pricing architecture:

- › Unique list prices by segment
- › Unique discounts or margin standards by segment
- › Sales coverage, e.g. outside vs. inside vs. unassigned
- › Freight schedules by segment
- › Technical support levels
- › Terms and conditions, e.g. payment terms, minimum orders

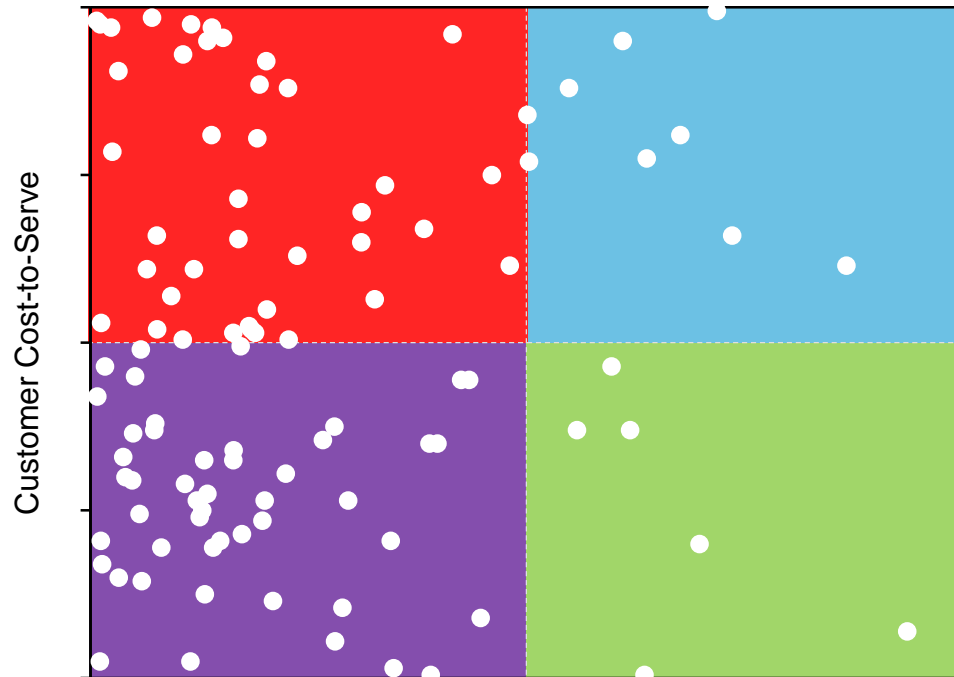
SELECT THE APPROPRIATE SEGMENTATION STRATEGY AND PRICING ARCHITECTURE FOR YOUR BUSINESS!

INFORM BOTH PRICING ARCHITECTURE AND SALES & MARKETING GAME PLANS

Customer Spend and Cost-to-Serve
Segmentation Profile

Segment:
Low Spend / High Cost
Price Level:
Opportunistic
Sales Strategy:
Remediation – up or out

Segment:
Low Spend / High Cost
Price Level:
Moderate
Sales Strategy:
Invest for growth



Segment:
High Spend / High Cost
Price Level:
Competitive
Sales Strategy:
Manage – shift to higher margin product, lower cost platforms

Segment:
High Spend / Low Cost
Price Level:
Aggressive
Sales Strategy:
Nurture – focus on service quality

ITEMS' PRICE SENSITIVITY PROFILES WILL VARY SIGNIFICANTLY



Highest Sensitivity



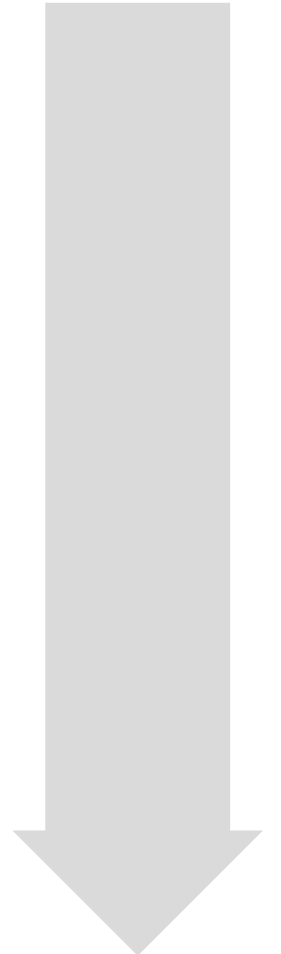
High Sensitivity



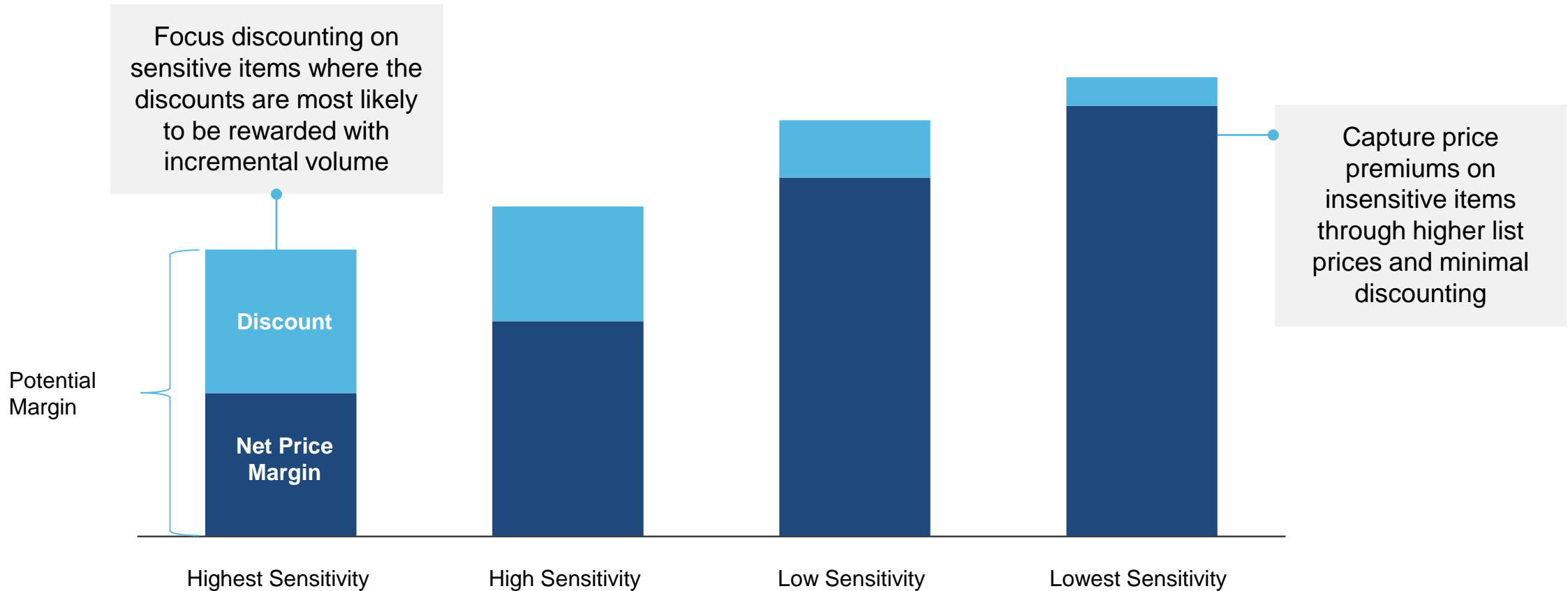
Low Sensitivity



Lowest Sensitivity



TARGET PRICE LEVELS SHOULD REFLECT DIFFERENCES IN PRICE SENSITIVITY



APPLYING STATISTICAL TECHNIQUES TO SALES DATA TO DERIVE PRICE SENSITIVITY OF PRODUCT CATEGORIES AND ITEMS/SKUs

ASSESS PRODUCT CATEGORY AND ITEM/SKU SENSITIVITY

Inputs:

- › Breadth of offering
- › Market share
- › Growth rate
- › Share of customer spend
- › Order frequency
- › Purchase volumes
- › Share of customer spend
- › Price variability
- › Win rates

Statistical Model and Managerial Judgment



Outputs:

Category and Item Sensitivities

- › Group 1; Highest Sensitivity
- › Group 2; High Sensitivity
- › Group 3; Medium Sensitivity
- › Group 4; Low Sensitivity
- › Group 5; Lowest Sensitivity

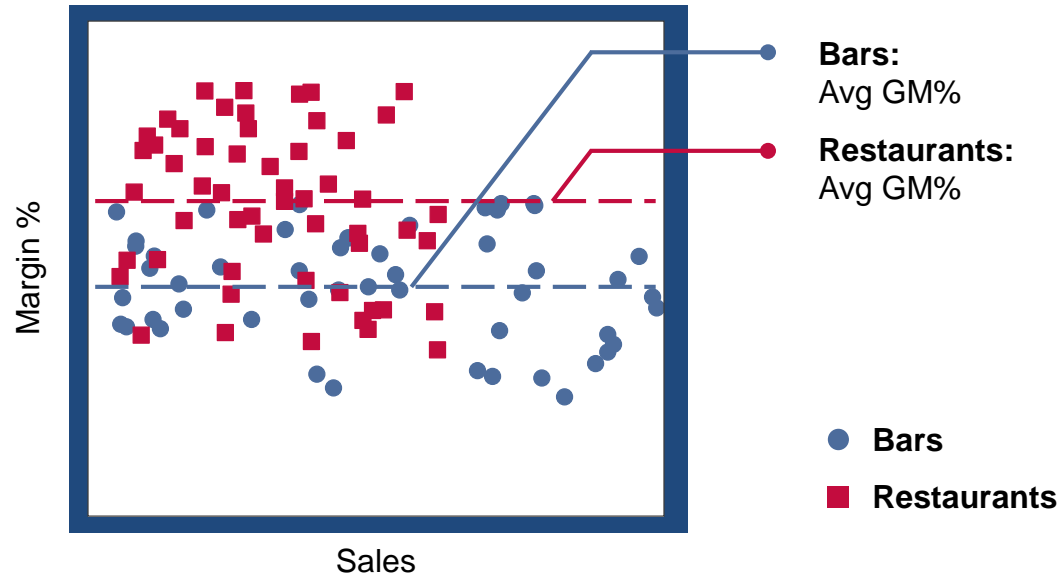
- Complement statistical model with qualitative management input at broader category level where internal product/market knowledge is generally available and number of categories is manageable
- Rely on statistical model alone for item-level classification where gathering management input on 1000's of products is impractical and unreliable

ANALYZE THE PROFILE OF EACH INTERSECTION OF CUSTOMER SEGMENT AND PRODUCT TYPE



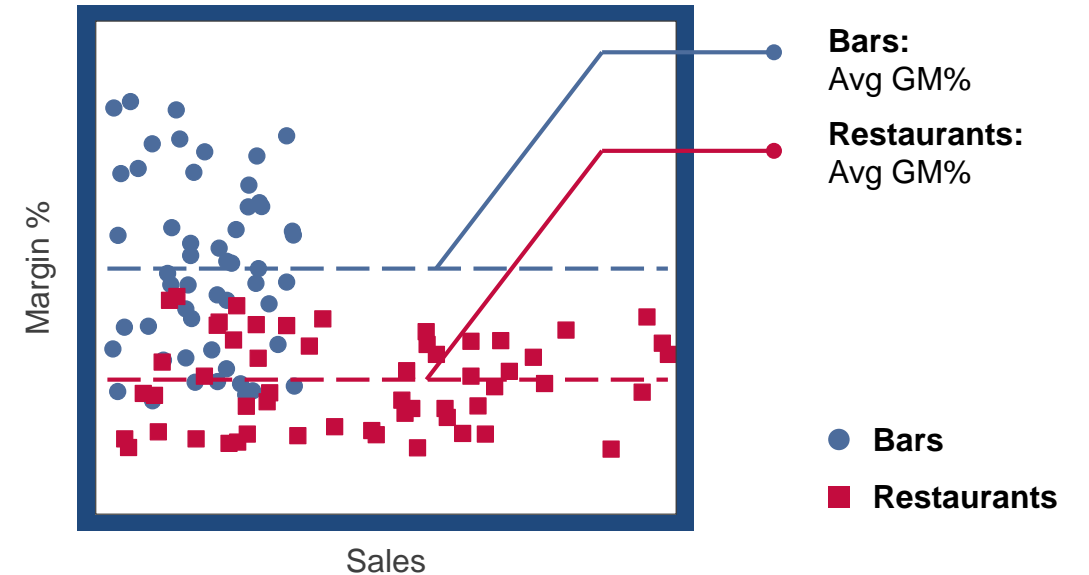
BEER

Sensitive for Bars and Less Sensitive for Restaurants



PRODUCE

Sensitive for Restaurants and Less Sensitive for Bars

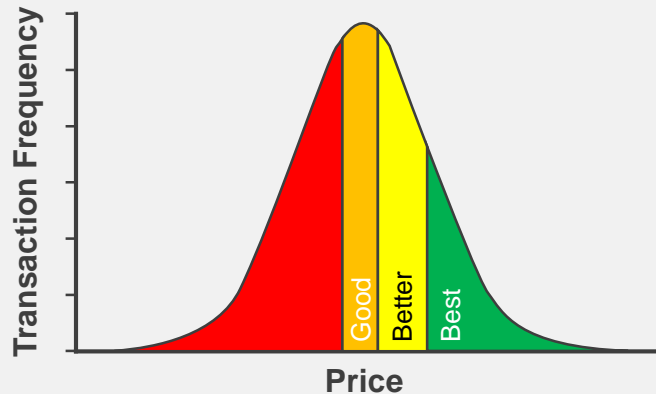


Different customer segments will have varying degrees of sensitivity to the same product category – your pricing architecture should reflect the unique sensitivity of the profile of each segment/category intersection



USE YOUR PRICING ARCHITECTURE TO ESTABLISH PRICING STANDARDS THAT GUIDE REAL-TIME PRICING DECISIONS

Price Distribution for Customer Segment
A Purchasing Product Category 1



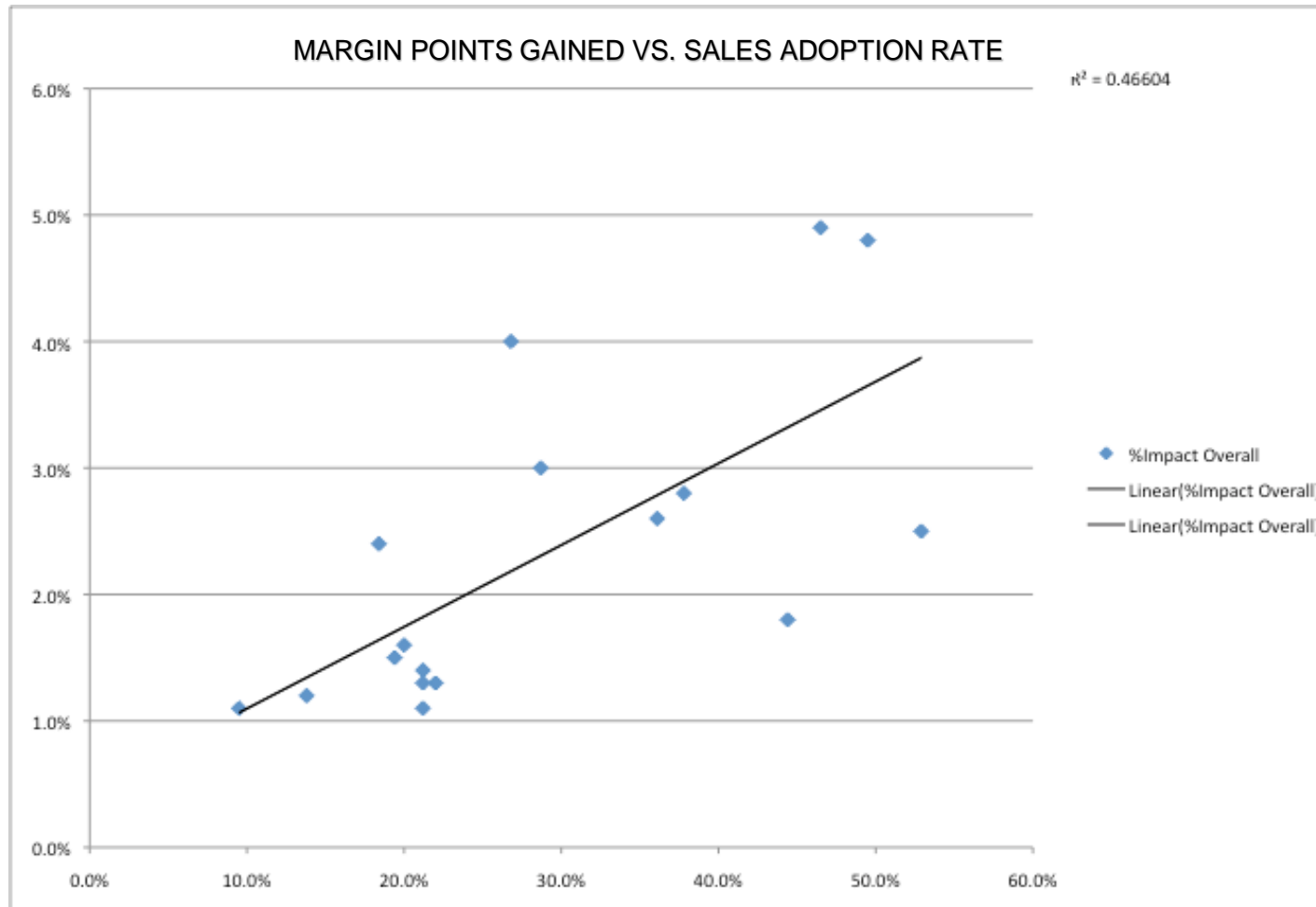
Real-time pricing guidance in the hands of
decision-makers

Customer	Product	Quantity	Good Price	Better Price	Best Price
ABC	123	10	\$42.17	\$44.56	\$47.09
DEF	456	100	\$12.02	\$13.87	\$15.26
GHI	789	1,000	\$1.25	\$1.35	\$1.45

Analyze the pricing data underlying each customer segment / product category intersection to define what good pricing looks like when that type of customer purchases that type of product

Provide those pricing standards to the individuals setting prices in the business at the time of decision

TRAINING DRIVES ROI FROM SEGMENTATION STRATEGY



NEGOTIATION MASTERY FOR THE ENTIRE ORGANIZATION



TACTICAL

Focus Areas:

- › Competitive
- › Tactical
- › Defensive
- › Transactional

RELATIONSHIP

Focus Areas:

- › Relationship
- › Preparation
- › Personality
- › Temperaments
- › Tools

STRATEGIC

Focus Areas:

- › Team Negotiation
- › Project/Large Deals
- › Personality
- › Types/Body
- › Language/Phone
- › Language
- › Versioning

ADVANCED

Focus Areas:

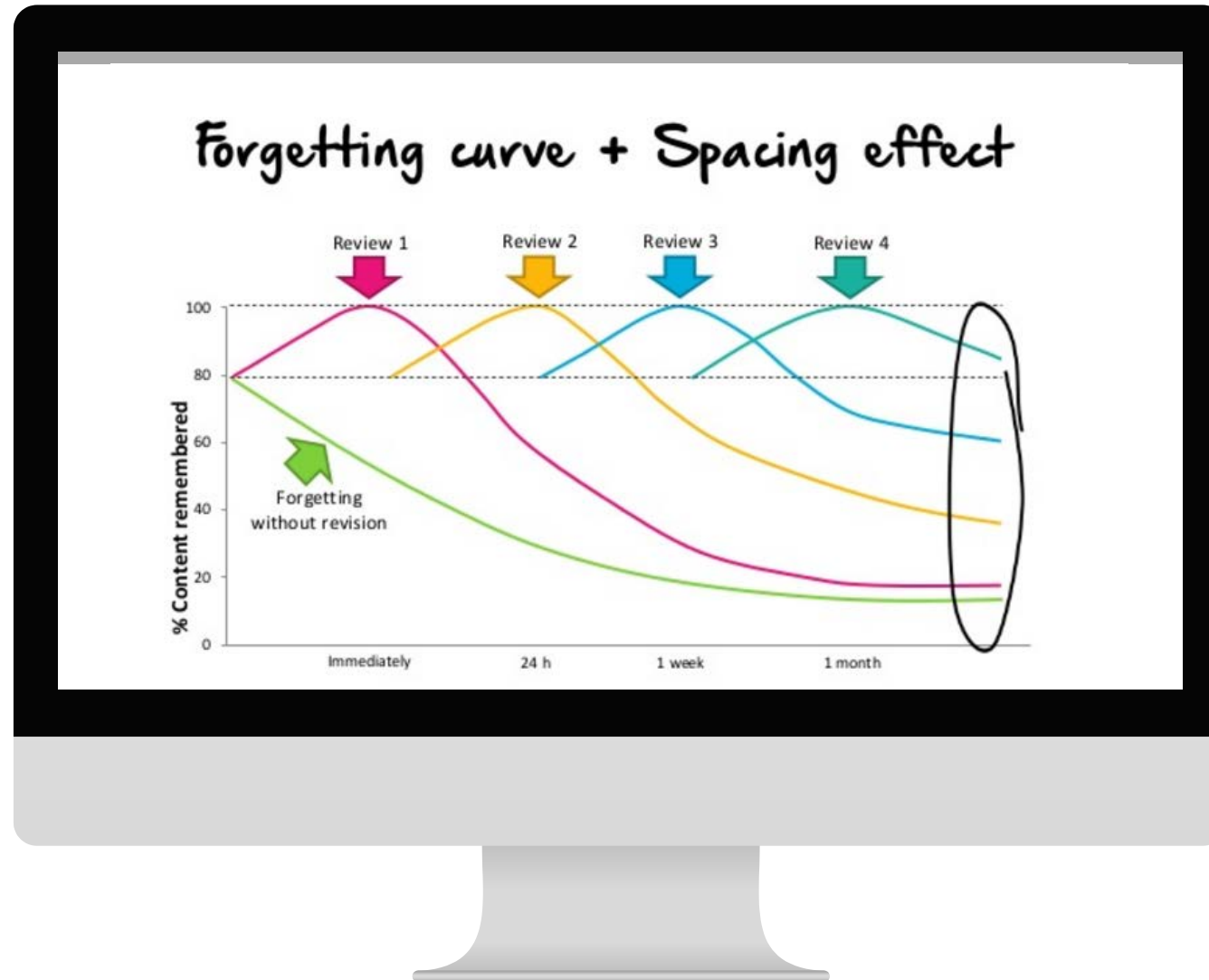
- › Strategic / Partnership
- › Differentiation
- › Staging
- › Value Architecture
- › Advanced Body
- › Language

MASTER

Focus Areas:

- › Competitive
- › Exclusion
- › White Space
- › Pre-emptive
- › Game Theory
- › Exclusionary
- › Staging / Collaboration

NEGOTIATION MASTERY FOR LONG TERM PERFORMANCE



MICROLEARNING OBJECT



CREATE ACCOUNTABILITY BY MEASURING AND REPORTING ON PRICING PERFORMANCE RELATIVE TO THE COMPANY'S STANDARDS

Sales Rep Pricing Performance Report

Sales Rep	Total Sales	% of Sales at GOOD Price	% of Sales at BETTER Price	% of Sales at BEST Price	Attainment %	Gap \$
1	\$1,008K	21%	33%	12%	88%	\$125K
2	\$5,628K	18%	23%	14%	91%	\$532K
3	\$4,727K	24%	15%	9%	85%	\$645K

Customer Pricing Performance Report

Sales Rep	Customer	Total Sales	% of Sales at GOOD Price	% of Sales at BETTER Price	% of Sales at BEST Price	Attainment %	Gap \$
3	100045	\$231K	21%	33%	12%	95%	\$11K
3	230005	\$112K	18%	23%	14%	82%	\$20K
3	005698	\$352K	24%	15%	9%	102%	\$0K





QUESTIONS?
THANK YOU