What Distributors Need to Know About Pricing Disruption

Featuring:
Brent Grover, Evergreen Consulting, LLC
Thomas P. Gale, Modern Distribution Management

August 24, 2017
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Brent Grover
Managing Partner
Evergreen Consulting, LLC

Thomas P. Gale
Publisher/President
Modern Distribution Management/MDM Analytics
FACING THE FORCES OF CHANGE
Navigating the Seas of Disruption

Paul St. Germain
With a special economic commentary by
NAW Senior Economic Advisor Alan Beaulieu

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# A string of bankruptcy filings

Here are retailers that have filed for Chapter 11 bankruptcy protection recently

<table>
<thead>
<tr>
<th>Company name</th>
<th>When it filed</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Gymboree Corp.</td>
<td>June 2017</td>
</tr>
<tr>
<td>rue21</td>
<td>May 2017</td>
</tr>
<tr>
<td>Payless ShoeSource Inc.</td>
<td>April 2017</td>
</tr>
<tr>
<td>Gander Mountain</td>
<td>March 2017</td>
</tr>
<tr>
<td>Gordmans Stores Inc.</td>
<td>March 2017</td>
</tr>
<tr>
<td>hhgregg Appliances Inc.</td>
<td>March 2017</td>
</tr>
<tr>
<td>BCBG Max Azria Group LLC</td>
<td>February 2017</td>
</tr>
<tr>
<td>The Wet Seal LLC</td>
<td>February 2017</td>
</tr>
<tr>
<td>Eastern Outfitters LLC</td>
<td>February 2017</td>
</tr>
<tr>
<td>Marbles Holdings LLC</td>
<td>February 2017</td>
</tr>
<tr>
<td>The Limited</td>
<td>January 2017</td>
</tr>
</tbody>
</table>

Source: Company reports
The truce between buyers & sellers

- Marketplace war: perpetual state of haggling
- Price tag (Wanamaker, 1860) – moral and practical
- Graduated price brands (GM, 1920s)
- Coupon clipping (supermarkets, 1940s)
  - Perceived worth – list price
  - Love deals– feeling or winning or losing
- Everyday low price (Walmart, 1990s)

Eroding terms of the peace

- Showrooming (Best Buy, 1990s)
- Internet retailing (Amazon, 1999)
- Predictive software (“Moneyball”, 2000s)
- Retailing: loosening the hold of the head merchant
  - Retailer data collection
  - Arrival of the economists

Source: Useem & Hariharan, Guru
Revenge of the sellers?

• The “right price”
• Variable airfare, surge-priced rides, pay-what-you-want album
• Gather data on spending habits
• Pumpkin pie spice, vending machine soda, headphones

Source: Useem & Hariharan
John Nash (Beautiful Mind)

- Buyers can’t process every piece of pricing info they receive
- Perception: “eggs and milk”
- Game theory: optimize inventory & prices
- Manage price perception (TVs & HDMI cables)

Source: Useem & Hariharan
Pricing truce in distribution

- Price book
- Bracket pricing
- List less discount
- Cost (some version of)
- Sales reps on margin-based commission
- Self-directed sales reps
- Computer pricing libraries / BCBI
Eroding the terms of peace for distributors

- Loosening the hold of the sales department
- Rebates / buying groups / growth incentives
- Internet distribution
- Showrooming
- Strategic pricing
- Customer profitability & cost to serve analysis
- Deviated costs from suppliers / sales reporting
- Sheltered income

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Price War: Power Struggle in the Channel

- Grainger
- Walmart
- Medical supplies
Pricing Actions – Deployment

By customer type

- U.S. Large Customers
  2016 Revenue $6.1B
  - More competitive: $3.7B
  - Less competitive: $2.0B
  - $0.4B

- U.S. Medium Customers
  2016 Revenue $0.9B
  - More competitive: $0.6B
  - Less competitive: $0.3B

By pricing strategy

- $7B U.S. Business (Large and Medium)
  - More competitively priced – Large and Medium:
    - Continued volume growth, GP margin below average
    - Increase prices as appropriate with inflation and other market factors
    - $4B
  - Less competitively priced – Large contract:
    - Declining volume, GP margin above average
    - Recapture business with lower prices during contract negotiations
    - $2B
  - Less competitively priced – Large and Medium noncontract:
    - Declining volume, GP margin significantly above average
    - Deploy web prices on all SKUs in Q3 and add marketing to acquire new customers
    - $1B
Grainger’s Repricing Strategy

• Digitization/price transparency has eroded premium pricing
• Customers expect big discounts off of list price
• “We lack confidence” in 7% price drop on 45% of business
• Trading volume for price is risky
• Bullish case: operating margins rise to 11-12% if cost take-out materializes (margin further drop from 40% to 38%)
• Bearish case: gross margins fall to 37%, op margins to 9-10%

Source: William Blair

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What’s my pricing strategy?

• Meet the comp
• Beat the comp
• Cost driven
• Value driven
• Relationships
• Scale

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Walmart lowers prices on a million online-only items

• In battle with Amazon
• Only if you opt for store pickup over shipping
• “Pickup discount” of $7 to $50
• “SmartCart” technology & Pickup Tower
• Revenue neutral to Walmart
• Testing curbside pickup

Source: TechCrunch, LA Times
What’s my service strategy?

• Product depth
• Product breadth
• Speed
• Technical support
• Innovative products
• One-stop shopping

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Amazon poised to disrupt medical supply industry

- "New features and unique benefits" (Chris Holt, leader of global healthcare)
- Downward pricing pressure + track record of reliable service + cost structure that kills
- Infusion pumps, catheters, sutures, hospital beds, scalpels...
- Owens & Minor 5% revenue drop, gross margin down 5.2%, net income down 22.2%
- Becton, Dickinson acquiring C.R.Bard ($24B); Cardinal acq. Medtronic supplies business ($6.1B)
- Won’t get into high-touch service and large contracts at first
- Moat: regulatory hurdles, special handling, licensing
- UPMC and IBM collaborating with Amazon to lower health care system costs

Source: Modern Healthcare
Where’s my moat?

• Exclusive products
• Distinctive services
• Customer intimacy
• Technical expertise
• Geography
• Regulations & licensing
• Scale
GROWTH

Selection

Lower Cost Structure → Lower Prices

Sellers

Traffic

Customer Experience

Source: Rob Green: Amazon
PORTER’S FIVE FORCES MODEL

INTENSITY OF RIVALRY WITHIN THE INDUSTRY

THREAT OF SUBSTITUTE PRODUCTS

BARGAINING POWER OF SUPPLIERS

BARGAINING POWER OF BUYERS (CUSTOMERS)

THREAT OF NEW ENTRANTS

ESSENTIAL MARKETING MODELS HTTP://BIT.LY/SMARTMODELS

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Digitizing is not the same as **Transforming**

Many companies have established mobile-friendly websites and a social media presence, but this type of digitization does not equal transformation. It is certainly better than nothing, and it does allow customers to find solutions online, but does not represent maximized transformation.
How customers want you to communicate with them

• Don’t want to hear from field sales rep as often as you may think
• Many prefer dedicated inside rep or CSR
  – 5 minutes on phone vs 30 minutes with rep
• Multichannel approach – direct-response, catalogs, flyers, digital marketing, marketing automation
• Regular touchpoints
• Multiple touches required before purchase

© 2017 Evergreen Consulting, LLC    Source: MDM, Real Results Marketing
Self-education preferred

B2B buyers prefer 3:1 to self-educate rather than speak to a sales representative.

Source: SAP

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Figure 6-1: Preference for Communications Frequency by Method

<table>
<thead>
<tr>
<th>Method</th>
<th>Never</th>
<th>Annually</th>
<th>Quarterly</th>
<th>Monthly</th>
<th>Weekly</th>
</tr>
</thead>
<tbody>
<tr>
<td>Email alerts</td>
<td>12%</td>
<td>5%</td>
<td>22%</td>
<td>41%</td>
<td>19%</td>
</tr>
<tr>
<td>Sales rep visit</td>
<td>16%</td>
<td>21%</td>
<td>28%</td>
<td>27%</td>
<td>10%</td>
</tr>
<tr>
<td>Phone call</td>
<td>25%</td>
<td>14%</td>
<td>35%</td>
<td>37%</td>
<td>8%</td>
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<tr>
<td>New product flyer</td>
<td>9%</td>
<td>9%</td>
<td>34%</td>
<td>28%</td>
<td>7%</td>
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<tr>
<td>Technical bulletin</td>
<td>16%</td>
<td>14%</td>
<td>23%</td>
<td>9%</td>
<td>5%</td>
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<tr>
<td>Print catalog</td>
<td>13%</td>
<td>50%</td>
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<td>9%</td>
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<tr>
<td>Webinar</td>
<td>29%</td>
<td>12%</td>
<td>21%</td>
<td>21%</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Real Results Marketing, MDM

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Customer Profitability & Cost to Serve
Pricing Metrics
Pricing scattergram
10 Things to Do

• Don’t try to beat the giants at their own game.
• Work more closely with suppliers.
• Don’t settle for mediocre profits.
• Use strategic pricing to elevate overall margins by 100-200 BPs
• Use customer profitability analysis
• Measure cost to serve
• Develop a pricing strategy
• Redesign your pricing process
• Make sure your ERP system supports your pricing strategy and process.
• If you need help, find a consultant who knows pricing and distribution.

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Questions?

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