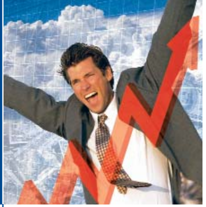


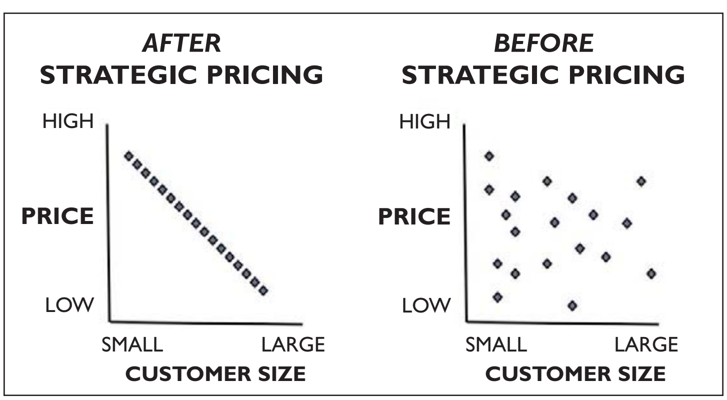
Strategic pricing for plastics distributors

by Brent R. Grover

Mahoning Plastics Distributors, doing $50 million of business, faced an all-too familiar problem: year-to-year sales were off over 20 percent, and the company had breached its bank loan covenants. The bank was threatening to call Mahoning's loan because projected cash flow would not cover payments due to the bank. Management at this imaginary, but not atypical distributor, made the two most obvious moves: they laid off excess staff and tried to dump bloated inventory. Unfortunately cutting staff and squeezing cash out of inventories was not enough to satisfy the bank. What to do?

Would you consider raising prices if your company were in Mahoning's situation? That is exactly what George, Mahoning's CEO, did! He had the disadvantage, and the advantage, of being new not only to the company but also to the distribution business. George could not understand why the distributor's sales representatives spent so much of their precious time managing prices, even on low-volume products at their smallest accounts. The reps were constantly on their phones quoting prices and negotiating with vendors for lower cost. They spend much of their office time auditing orders and making price changes on the computer.

George also found that his reps had little or no market pricing information. They had some feedback from a handful of their own customers, of course, as well as their general impression (right or wrong) of what margins should be competitive on a few of the company's product lines. The lowest "last bracket" prices in the Mahoning price book were too high — out of touch with reality — so if referred to at all they were only a starting point for discounting. When quoting, the sales reps just wanted to know Mahoning's cost for the item, and then they would apply an arbitrary percentage to come up with a selling price. They mostly used the same margin percentage for all items in a product line. They also used the same margin percentage "rule of thumb" no matter what industry the customer was in, and also the same margin percentage no matter how small or large the customer.



George engaged an expert to help his staff do a statistical analysis of all transactions for the previous 12 months. It took less than three weeks for the analyst and his computer program to segment the customers, organize them by size, group the product lines and analyze price sensitivity. The program then calculated a margin index for each item. The last step was producing pricing look-up tables to be used to adjust the margin indexes based on customer segment, buying power and item sensitivity. The result was recommended pricing for every item that customer bought. Below-market margins were to be brought up to market levels whenever possible, all at once or gradually depending in the situation.

The sales reps were taught how "strategic pricing" worked and were given the margin goals for their customers, by item. Larger increases were sought on less sensitive items and for smaller customers. Smaller increases were recommended for more sensitive items and for larger customers. Most prices for larger customers were left alone, except for the least sensitive items. Prices under contract were not touched. The sales reps screened the proposed new prices and made decisions about trimming or postponing increases to selected items for some of their customers.

Mahoning's information system professionals plugged the margin indexes and pricing look-up tables into the company's ERP system. Most of the thousands of "special contract price and cost records" were cleaned out of the system. Strategic pricing made most of those hard-to-maintain records unnecessary.

After review by the sales reps, the new prices were applied to customer transactions. Margins on some low-profile items for small customers increased by several percentage points. Margins for other items increased by lesser amounts, or not at all. Mahoning did not reduce margins determined to be above the market level: the goal was profitability, not perfection.

In spite of the fears of some of the sales reps, there was almost no significant negative reaction from the customers. The initial phase of the strategic pricing project resulted in an overall increase of 200 basis points, or a 2-percent increase in gross trading margin. The margin improvement translated into an immediate jump in gross margin dollars of almost $80,000 per month (approximately $4 million monthly sales @ 2 percent). Under Mahoning's sales compensation plan, about 20 percent of the increased margin or $16,000 per month, went to the sales reps. The balance went straight to the company's bottom line: over $60,000 per month, nearly $750,000 per year.

For Mahoning, at a $50 million annual sales rate, the $750,000 operating profit increase translated into 1.5 percent of sales. In terms of return on investment, a $750,000 leap in operating profit represented going from a $300,000 loss to a $450,000 pretax profit. As a group, the sales reps enjoyed almost $200,000 in additional annual commissions. The immediate improvement was enough to restore the bank's confidence in the company.

Strategic pricing freed the sales reps to make the "highest and best use" of their valuable time: presenting new products and concepts, and building customer relationships. The reps learned to delegate most routine pricing activities to the support staff, and with better market pricing information they became more adept at negotiating deals with larger customers. Using the margin indexes and pricing look-up tables in the ERP system, the inside sales staff became empowered to quote market-driven prices to new customers and pricing on new items to existing customers.

George and his imaginary management team dealt with a serious challenge in front of many wholesale distributors today. They responded to the threat in the usual ways — staff and inventory reductions — but also with a creative response to a common problem: sales reps overwhelmed with pricing tasks, yet starved of market pricing information. The data you need is already in your system. It's up to you to turn the data into information, and the information into profits. ■

Brent R. Grover has written five books for the *NAW Institute for Distribution Excellence* as well as numerous articles about distribution management for industry publications. He is also a popular speaker at wholesale distribution industry gatherings. Grover is the most recently appointed of the four NAW Institute Research Fellows. His newest book, about strategic pricing for distributors, includes significant research about best (and worst) distributor pricing practices, will be available soon at www.nawpubs.com. Grover is managing partner of Evergreen Consulting, advisors to the distribution channel on strategic planning, mergers and acquisitions and profit improvement. He serves as a director of several companies. He has been CEO and co-owner of an innovative and successful distributor. He also served as chairman of the National Paper Trade Association (NPTA) in 1993. Grover can be reached at Evergreen's Cleveland office (216-360-4600, ext. 101) or brent@evergreen-consulting.com.