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The Price is Right:

Going from Reactionary to Strategic Pricing

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When your team meets for that post-event brain dump after the latest manufacturing industry trade show, they often repeat what they discussed with industry peers over the previous days. Too often, these discussions evolve to what companies are doing with their pricing strategies. And because the answer to pricing strategy questions often involves, “We’re looking at a new AI-powered analytics solution,” we’ve observed that this topic deserves a longer and more thoughtful exploration.

We’re still in the early stages of Industry 4.0, but the inherent efficiencies are transformational. Artificial intelligence (AI) algorithms can perform a variety of tasks in multiple domains. They can predict and prevent equipment malfunctions, which cost manufacturers up to $50 billion annually in unplanned downtime. They can also extend the life of equipment. AI can even streamline efficiencies across energy use, workforce safety, and staff productivity. But the universal need that AI could fulfill across all industries is still dependent on setting the right price.

Manufacturers especially recognize that AI packs a powerful punch when it comes to their pricing strategies.

From real-time pricing optimization updates and rebate program recommendations to marketing development fund campaign insights, business intelligence (BI) analytics and predictive simulations add horsepower to informed business planning. Year over year, there’s been 10% growth in BI/analytics tool revenue, with an anticipated spend of $26.3 billion in 2019, according to IDC. And Gartner reports that 91% of organizations haven’t yet reached “transformational maturity” using their data and analytics.

Getting There from Here

Data governance powers the AI machinery. Since predictive modeling, prescriptive analytics, and machine learning rely on historical data to divine the behavioral patterns and affinities of distributors and products, data hygiene is key. While data mining tools can adapt to small gaps and smooth out irregularities, large blind spots in data—or conflicting data—will generate misleading results that match the caliber of the misleading data feed. Once protocols are in place ensuring data hygiene, that clean data needs expert discernment to benefit the manufacturer. Protocols must be deployed and mandated so that every employee who touches that data is accountable for its purity.

As Gartner senior analyst Thomas Lamonte pointed out, “Stockpiling data analytics technology does little good if no one uses–let alone masters–these tools.” To that end, synthesizing actionable strategies from the data hinges upon hiring the right person–a data scientist. Today’s modern manufacturing organization needs a data scientist on staff who understands the manufacturing industry and has a strong foundation in statistics and software engineering to prioritize tasks and deliver impactful insights.

Covert Rebates That Add Intelligence

One of the greatest challenges for manufacturers is getting their distributors to share detailed sales information. From the distributor's viewpoint, it feels threatening to share information because they fear the manufacturer will undermine them, sell directly to their customers, and cut them out of the process that often includes some significant added value. Realistically, manufacturers have little incentive to start renting semi-trucks and delivering pint-sized orders to small, locally owned retailers. But this persists as the hidden objection many manufacturers must overcome.

So, how do manufacturers gain access to key customer information? For many, it starts with the wholesaler rebate program. For instance, when manufacturers offer their distributors a 2% rebate on everything they buy every time there's a sales order, the manufacturers are not learning anything. Instead, they're just giving away 2% on every order.

The more advantageous approach is to set it up so it's not 2% on what they buy from the manufacturers, but rather on what they sell to their end customers. The distributor will still earn 2%, but now they can be required to claim the rebate and show the manufacturer what they have sold first before they collect the bonus. To earn 2% on their sales price, the distributor must also reveal its sales price. And in the process, the manufacturer receives market intelligence for this buy outlay.

So, what can manufacturers discern from this program approach?

Distributor inventory (inventory sales to distributor, minus rebate units claimed)

Customer geo-information (at minimum, zip codes should be reported)

Distributor selling price (sensing local market demand)

Product mixes (upsell, cross-sell or bundled promotion opportunities)

Smart distributors will view their data as an asset and will be willing to negotiate the transfer of this data in exchange for some margin. The smart manufacturer will be able to derive greater value from this data than the cost paid to obtain it. Manufacturers can exploit this data to identify trends, such as where they need to focus their advertising efforts, how to best motivate their distributors, or even in evaluating their own pricing. To drill down further, AI can help manufacturers gain insights about:

Inventory levels: If the distributor's inventory is too low, the probability for an out-of-stock situation is higher. This means losing that sale to a competitor with ready inventory. Manufacturers might consider rewarding wholesalers for carrying a slightly higher inventory than they desire, just to prevent an out-of-stock event.

Zip codes: Zip codes will demonstrate the underperforming regions that need more love and additional advertising. Manufacturers might create marketing development funds specifically for regional distributors, or, limit a national distributor's eligibility for purchases in the most successful territories. This information may also help manufacturers to discern regional buying preferences, such as clothing due to the climate, or a recipe due to the cultural palate. Manufacturers might also identify the alternative products they could be adding or substituting to the product mix that they're offering to their distributors.

Distributor selling price: If the distributor is selling the manufacturer's product at too high of a price, it is likely the acquisition cost from the manufacturer is also too high. There isn't enough margin for the distributor—or perhaps at the retailer—to discount down to an appealing price point for the consumer. Competitive forces in the market can also be sensed, and third-party data might be purchased to confirm these suspicions.

Regional sales profiles: Beyond the major accounts, learning who, where, and at what price sales are occurring for SMB retailers helps to develop a sales profile that will assist the manufacturer in production and sales planning. What are the regional successes within major accounts? For example, the snack food maker wants to know whether medium-hot salsa at Super Bowl parties has a bigger draw in Texas than in the upper Midwest.

Getting the Price Right

Machine learning (ML) occurs when the developed algorithms are constantly incorporating new information, crawling through the ever-growing data to find new trends and demands to fold into predictive calculations. For ML to work, it needs quality data. ML needs to be fed histories on the products and segmentation of the distributors or vendors who bought them, plus their quoting behavior. Manufacturers need to have a business process and related IT systems with appropriate structures in place to capture and curate this data.

Additionally, ML must know the product descriptions and pricing, the history of past rebates or incentives for wholesale distributors, the current inventory levels, and the volume of distribution throughout regions and business units, plus the competitor products and pricing.

ML also can match a cluster of look-alike products to those the manufacturer is price optimizing, using a regression tree of “if-then” statement sets that are based on historical sales data to yield a prediction. These predictions can be compared against actual sales, and the machine can then refine its learning based on these results.

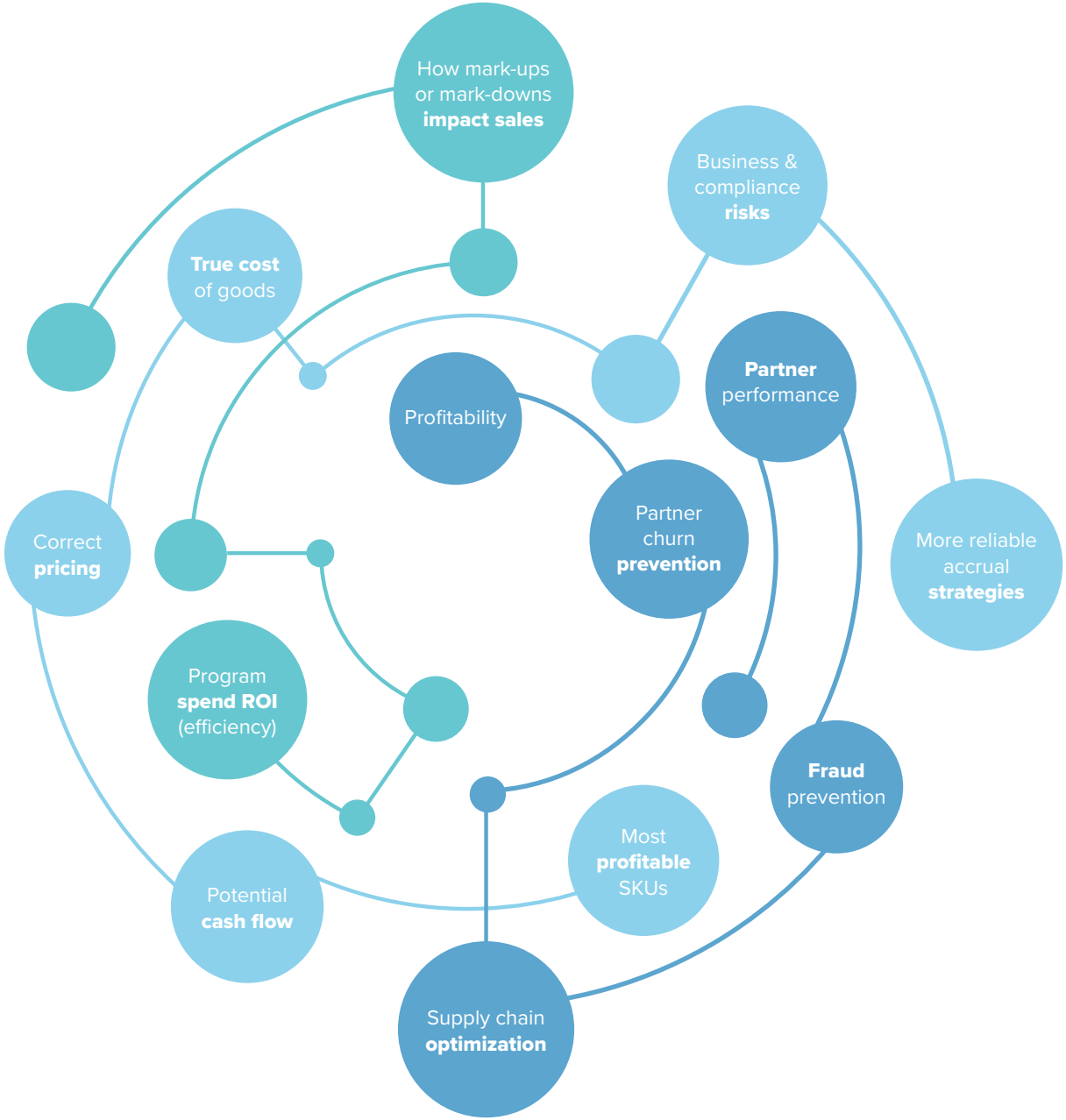
Manufacturers can also rely on ML to help them understand how their customers will react to varied pricing strategies and then identify the best prices based on their goals. Knowing the potential impact of sales promotions or rebates, competitors, weather conditions, seasonal sales forecasts, economic conditions, operating costs, and regional demand all play into formulating pricing guidance:

ML is a powerful tool that can handle millions of SKUs and sales transactions to optimize prices regionally and dynamically, based on the manufacturer's pre-defined rules. ML continues to learn, building its own pricing automation by using its algorithms to identify and learn from the data's patterns.

One manufacturer using ML to optimize pricing and provide real-time price intelligence to its sales reps reported 35% of the ML-recommended prices were adopted. This manufacturer realized a $1.3 million revenue increase and a 10% win rate increase.

Forecast Planning Mastery

Growing a manufacturing business requires understanding what is or isn't working—now, and on the horizon. Informed decision-making and goal-setting should drive everything. Artificial intelligence can quickly provide key insights that identify business risks and opportunities with greater ease and efficiency. Manufacturers can learn distributor and customer behaviors—including purchasing patterns, claims accuracy, and promotional effectiveness (which also helps improve supply chain satisfaction). Reliable knowledge that is delivered in real time empowers forecasting and planning. Predictive analysis becomes a super power, revealing the following:



Armed with this depth of detailed information, profitability and growth inherently add up.

The Critical Role of Software

Manufacturers who are supported by software that manages the full lifecycle of their pricing optimization programs will have a strategic advantage in the marketplace. By capturing detailed supply chain performance data in a structured repository with machine learning capabilities, manufacturers (and their supply chain partners) can get instantaneous answers, rather than enduring hours of searching for data, doubting its integrity and manually studying its secrets. In the end, data leads to insights, and insights lead to profits.

Vistex Software Solves Pricing

Vistex software offers manufacturing clients a proven solution to address pricing challenges, such as providing discounts and on-order pricing to ERP, eCommerce and CRM systems. Our analytics solutions continue enabling our customers to decide the best pricing and to evaluate their margins, in addition to solving their long-standing issues with claims, funds tracking, and contract management.

About the Author

Matthew Hays is the Director of Product Management at Vistex. In this role he manages the roadmaps for new product development, supports marketing and sales functions, and maintains business partnerships. Matthew has a long history with manufacturing, supply chain, life sciences, software lifecycle management, project management, and customer engagement.

About Vistex®

Vistex solutions help businesses take control of their mission-critical processes. With a multitude of programs covering pricing, trade, royalties and incentives, it can be complicated to see where all the money is flowing, let alone how much difference it makes to the topline and the bottomline. With Vistex, business stakeholders can see the numbers, see what really works, and see what to do next – so they can make sure every dollar spent or earned is really driving growth, and not just additional costs. The world's leading enterprises across a spectrum of industries rely on Vistex every day to propel their businesses.

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