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$1 Trillion on the Table:

What B2B Companies Stand to Lose Without Price Optimization and Management Solutions

By Robert Irwin and Mitchell D. Lee

Abstract

- 2020 had severe impacts on corporate revenues and global market demand.
- As we emerge from the pandemic, there are expectations of extraordinarily strong growth in 2021 and beyond.
- However, without price optimization and management (PO&M) practices and solutions, companies may miss out on significant profit opportunities during that rebound.
- Using a conservative formula, it can be projected that over the next five years, Global Fortune 500 B2B firms might miss out on one trillion dollars in potential profits.
- What are the solutions that can help them capture those profits?

The impact of 2020

The impact of 2020 was felt broadly and deeply in both the market and the home. Compared to 2019 levels, revenue for the Fortune 500 dropped by 34%. There was significant demand destruction: consumers significantly cut spending, and sectors like travel and entertainment saw their business grind to a complete halt.

At the macro level, the US Commerce Department reported that **gross domestic product fell 3.5% in 2020** versus 2019. Compounding the demand side profitability impact, manufacturers saw heightened cost volatility for both raw materials and production inputs. In fact, many input commodities related to process industries saw increases that are still being sustained.

It is inevitable that every slowdown sets up the next period of growth. Pent-up demand is already appearing, priming the economy for a burst of growth in 2021. Oxford Economics has predicted England's output growth at 7.2%, the strongest growth in decades. In a Wall Street Journal poll earlier this year, economists on average expected US gross domestic product to expand by 6.4%.[1]

Due to the unprecedented volatility in demand, supply chains that were tuned to handle variations of up to 5% have seen changes far exceeding standard process control mechanisms. Costs for inputs, when available, have often varied even more wildly.

How to deliver growth and profitability during disruption and rebound?

Amid all this turbulence, how can a business continue to deliver on its promise of growth and profitability? Fundamentally, there are only three levers available to a business to control profitability: cost, volume, and price. For a long time, almost all profitability improvements efforts were focused exclusively on minimizing costs, many business initiatives have been organized to implement outsourcing, offshoring, lean manufacturing, just-in-time supply, and invoice price accuracy programs. These programs were easy to measure, sometimes easy to achieve, but they have, for the most part, all been done – leaving little marginal benefit for the additional effort required. And while R&D is indeed a cost, cutting here rarely makes sense in a viable organization and should be avoided.

Volume growth is a typical goal. If you are trying to do this without using the price lever, it's tough to make major gains, especially in mature markets. Most often, it comes through acquisition, demands a premium, and therefore adds costs. And at the end of the day, a growth-based acquisition does not guarantee profitability.

So, what are companies left with? Price. Price always has been, and always will be, the most powerful lever for profitability. The challenge for today's modern enterprise, in today's turbulence, is to manage that powerful level with agility and granularity.

A trillion in profits left on the table

What are the consequences of failing to optimize pricing in order to maximize profits as markets experience a rebound? Simply put, there is an enormous amount of potential profit that will be "left on the table" by B2B enterprises if they are not attentive to profit and margin opportunities. If the past year has taught us anything, it is the lesson that maintaining profitability applies just as much during booms as during busts. It's a key constituent of business continuity and sustainability.

Just consider how much profit opportunity will fall by the wayside without a focus on price optimization and margin management.

- In 2020, the Global Fortune 500 earned revenues totaling $33T.[2]
- Conservative estimates for the B2B portion of that revenue total range from 50% to 67%; for the sake of this exercise, we will use 50%. [3]
- Companies using Price Optimization and Management (PO&M) practices and solutions typically realize bottom-line benefits in the range of 1% to 3% of top-line revenue (and often much more), based on our experience. Let's use a conservative estimate of 1.5% return on sales.
- Gartner indicates that while some companies have implemented PO&M solutions, 86% that could benefit from doing so have not yet taken steps.[4]
- Over the span of just five years, that lack of PO&M across Global Fortune 500 B2B firms adds up –to **one trillion dollars in profits left on the table** (Again, based on conservative numbers).

What's the basis for $1T?

Global Fortune 500

Total Revenue Earned in 2020 by the Global Fortune 500	B2B Revenue (at least 50%)	B2B Annual Bottom Line Benefit of a Typical Pricing Initiative (1.5% of Top Line Revenue)	Portion of Companies that Could Benefit from PO&M (86%)	What's on the Table (Over 5 years)
$33T	(50% of $33T) $16.5T	(1.5% $16.5T) $248B	(86% of $248B) $213B	($213B x 5 years) $1.06T

Why haven't companies addressed the issue?

The obvious question to ask is: why have companies not yet addressed this issue? One reason is that agile and granular control of pricing requires successful execution of a pricing strategy. And that involves much more of an organization's attention than simply issuing a price list.

Various people across many corporate functions are involved - or think they should be. Invite any consultant into your house and the first thing they will do is draw you an organization map with all the participants who believe they have a role to play in pricing. If price is thought of as "just a number", then price control ends up owned by finance. In other organizations, it is left to the product manager to set a target. Occasionally that sticks but, more often than not, sellers expect to have the latitude to do whatever is necessary to "win the deal".

Occasionally, a centralized deal desk or pricing group covers that function for the business. But rarely does a P&L owner, GM, or C-suite get involved with pricing. It's true that there are far too many details for this level of leadership to get "into the weeds" but ultimately, they are responsible for profit. In fact, large purchasers often leverage this disconnect between pricing and profitability by creating artificial crises that invoke the "white knight" syndrome.

Senior business leaders on the supplier side are enticed to swoop in at the last moment, to "save the deal" by offering huge price concessions, bypassing their own strategies as executed by their own teams. After snatching the deal from the jaws of defeat, these leaders proudly parade the win. But they generally have not had time to understand the specifics of the deal; they might have only won an actual loss of profit. And they very likely don't understand the long-term implications of their "win" – they might have started a market movement, culminating in a race to the bottom for the entire industry.

What solutions are available?

There are many approaches to the application of Price Optimization and Management software , but generally, four key areas need to be addressed. We'll go through these sequentially, but often the first two or three are done in quick succession or even in parallel.

First: Measurement

There are lots of BI tools on the market that support reporting requirements, but few have specific processes outlining how to solve a problem. The best way to solve pricing problems is by organizing data and pricing decisions, through the use of a pricing waterfall – an approach to analysis and uncovering margin leakage, augmented with analytical playbooks. There are some specialized software capabilities that you need, but most of this work involves a high degree of process evaluation - and often that identifies the need for change management.

Second: Tactical control

So, you've found some problems. And, most likely, you've found some undiscovered successes that can be more broadly applied. With a platform for management, control, approval, measurement and validation, you can now go after low-hanging fruit. This is critical - to build up the organization's engagement and desire for further improvements in the commercial processes.

The secret to success here is that the pricing platform is integrated with your existing data and your existing enterprise platforms – from CRM to ERP. The controls and approvals fit seamlessly.

Third: Strategic deployment

Now, with integrated measurement and management of your tactical execution, it is time to leverage your enterprise capacities to deploy your high-level strategy – that drives specific, granular decisions and actions. And importantly, the same capabilities mean that you can easily validate the performance of your strategy and adjust your strategy where and when as needed.

Fourth: Agile optimization

At this point, the capabilities of your pricing solutions have been largely focused on the control and management aspects. Broadly speaking, the benefits here are in the 1 to 3% of revenue dropping to the bottom line. Organizations with mature commercial processes, connecting front-office CRM systems to back-office ERP systems with enterprise capabilities for pricing and selling are routinely achieving these performance levels.

The fourth area – optimization – is where the real benefits are realized. And it's important to take a "business" view of optimization: the ability to evaluate each and every customer / product intersection when setting prices. And even more importantly for B2B organizations, the ability to provide pricing guidance for negotiations, reflecting your pricing power for that product at that customer, as well as your commercial risk for that product at that customer, line item by line item. Further, you must have an assessment for overall pricing power and risk for the total combination of the offer being negotiated, in the context of your total book of business.

Making optimization models relevant

The increase in speed of change in the market seems to be exponential. 2020 significantly accelerated the use and variety of data involved in the commercial process. Negotiations are moving online, with customers increasing their demand for self-service platforms that support not only their ordering process, but also the initial purchase and price negotiation. Suppliers need to keep up to remain in the competition.

Solutions offering AI-based price or margin optimization need to be able to keep up with the speed of market change. This requires the real time and automated management of data input with the flexibility to support multiple data sources: transactions, deals, win-loss and external market indices.

The speed of change also means that ownership for the modelling and the guidance definition need to sit firmly and squarely inside your organization. Having to call up and book a consultant every time you want to tweak the model is no longer fit for purpose.

Once you have established ownership for the definition of the segmentation model and corresponding guidance, you need to ensure Sales adoption: of the targets, of the solution and in their willingness to trust the model. This clearly comes from the use of what is known as a 'Glass Box' rather than a 'Black Box' approach to optimization.

This is a B2B-specific requirement. The use of thousands of tiny micro-segments that have no meaning to the business is just inappropriate in the B2B environment. You need to be able to explain the model to Sales users in plain and clear language. Sales needs to understand where they sit with their price (or margin) decision in the model. And why, as related through transparent, easy-to-understand segment descriptions, they should trust the guidance they are presented with. This drives adoption, use of the guidance and, ultimately, better margins and a bigger share of that $1T in potential B2B profits.

Conclusion

One trillion dollars is a significant – some might say a stunning – amount of profit that may be lost by global B2B companies that fail to modernize their approach to pricing optimization and management over the next five years. In good markets or bad, profitability is crucial, as we've all been taught by the events of 2020.

So, it's incumbent on companies to learn how to best optimize pricing and go after their part of that $1T. Pricing optimization and management solutions that are purpose-built for today's modern business processes are fundamental enablers of transformation. These platforms help organizations deploy and control best practices as they drive improvements in their commercial processes.

And of course, technology by itself is not sufficient.

Transformation also demands the skills and knowledge of people who have experience, credibility, and the diversity of talents necessary to pursue a long-term profitability goal. They must be supported by robust, well-defined processes that go beyond the initial purchase and installation of software; they should encompass change management support and ongoing business improvement cadences, with quarterly or even monthly engagements for verifying and validating what's working, what's not, fixing problems and amplifying success.

In short? To claim the "lost" profit opportunities outlined in this document, B2B companies need to commit **now** to pricing optimization and management.

Authors

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About Vendavo

Vendavo provides leading-edge pricing and sales solutions with embedded AI to empower global manufacturers and distributors to digitally transform their commercial operations in order to unlock value, grow margins and accelerate revenue. These Commercial Excellence solutions, combined with its award-winning value consulting services, enable Vendavo to deliver outcomes that are not only predictable, but unrivaled. That enables the most demanding B2B organizations to develop dynamic customer insights and optimal pricing strategies that maximize margin, boost sales effectiveness and improve customer experience.

Vendavo has headquarters in Denver, with offices in the UK, Germany and Sweden.
For more information, please visit http://www.vendavo.com