Tackling the Top 6 Pricing Challenges in the Chemical Industry

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Introduction

The chemical industry faces a number of challenges setting prices. For example, relentless price competition and significant cost fluctuations challenge many companies to accurately set prices. At the same time, they are trying to align prices to value and sell that value in order to target the right prices to the right customers. This white paper highlights the top six pricing challenges facing the chemical industry today and how industry-leading companies are tackling these challenges using pricing best practices and technology solutions.

Challenge 1: Relentless Price Competition

Chemical manufacturers are facing relentless pressure on margins through aggressive price competition fed by volatility in demand. In the midst of this competitive environment, companies must ask themselves several key questions. Do you have the right information to make price decisions? Can you easily see market trends in pricing? Do you have the information and tools you need to estimate the impact of price on volume and mix?

Based on our extensive experience working with companies in the chemical industry, we have a few suggestions to help you answer these questions.

Fight with better information
Separate facts from emotion. Be aware that aggressive buyers can make it appear that the entire market is exclusively focused on price. Trust, but verify when asked to lower a price. Customers and even sales reps have incentives to be selective with information sharing. Keep your ear to the ground on competitive moves and look for trends, rather than anecdotes. Monitor trends in terms of win rates and order volumes to spot slippage with key products or segments, and to ensure compliance with contracts.

Pick your battles
It’s essential that you know which pricing battles you can win – and more importantly – which are worth winning. Avoid situations where you are clearly at a disadvantage, and hold your pricing resolve when the value you deliver assures a competitive advantage. You have to be willing to terminate unprofitable customers by establishing a walk-away price before the negotiation begins, which is especially true with customers who are ardent price buyers. Your goal should not be to “win at all costs,” but to maximize ongoing
Managing cost fluctuations and keeping prices in-sync is essential to preserving margins and profitability. Focus your resources on uniquely serving customer segments where price cuts are not the dominant requirement to preserve the business.

**Emphasize non-price buying factors**
Your best pricing strategy is often to redirect the battle away from price and toward your marketing strengths, including stability of supply, innovation, technical assistance and customer service. Identify and separate your price buyers from value buyers by taking away services when price reductions are required. Train your sales force to negotiate with well-defined value propositions – and don’t assume your sales force already knows how to properly convey critical value messages. Think about additional training in negotiation skills and value-selling. Also, consider sales incentives that reward price quality and profit generation rather than simply volume.

**Look beyond short-term gains**
Weigh the long-term consequences of pricing decisions against the short-term gain of price concessions. Ask yourself why competitors are choosing to fight on price in the first place? Is it because of their product or service disadvantages? Remember, your pricing decisions should enhance your company’s long-term ability to operate profitably. Training customers to only respond to price reductions as a motivation to buy jeopardizes your future.

**Challenge 2: Significant Cost Fluctuations**
Setting prices that are subject to wild swings in raw material and energy costs is an ongoing challenge in our current economic environment. This creates tension with customers who may want longer-term contracts with stable pricing. Managing cost fluctuations and keeping prices in-sync is essential to preserving margins and profitability and there are strategies that can help.

**Centralize the pricing function**
Establishing a centralized pricing team, closely linked with supply chain, will equip you with the ability to manage prices more consistently as you respond in a volatile cost environment. Conduct scenario planning around potential costs to help understand how price changes impact margins. Establish processes to support field-based personnel, who under increasing pressure to close deals may not have the time or access to market trend information to negotiate deals that consider latest cost fluctuations.

**Set prices with forward-looking costs**
Do not allow extended quote or contract durations to be negotiated without an appropriate price premium. Without a proper review and price adjustment, long contract periods are transferring the market risk to your company. Pricing using replacement cost can improve profits. It helps if you take time to understand industry capacity levels and drivers of market demand so that you can improve forecasting costs and prices 6-12 months out.
Many chemical manufacturers are ‘flying blind’ when it comes to understanding the profitability of customers, products, and individual sales transactions. Too often, companies automatically agree to customer requests for favorable pricing, additional services, additional order fulfillment items, even free products and services. Accepting returns and sending replacement product on an expedited basis, allowing rush orders for free, or providing free technical help without adjusting prices can significantly reduce profitability.

There’s no way to resolve these issues without a solid understanding of the profitability of each customer and each transaction. But gaining insight into transaction profitability requires a process and tools that can help you find and correct low-performing customers – with a clear understanding of the root-cause of poor performance.

Identify which transactional cost links to the right operational lever to pull to increase margins. You must manage your transactional cost-to-serve through techniques such as price waterfalls. Focus on the biggest controllable item on the waterfall, whether it is free services, freight, or other unrecovered costs.

Start with basic analytics
To understand existing price variability, you need to look at the dispersion of existing prices. Wide price dispersions often signal the greatest profit opportunity if managed properly. Scatterplots with price or margin along the vertical axis, and account size along the horizontal axis, provide another simple but effective way to test for price consistency – or inconsistency.

Find root causes for outliers
Look at margin outliers among customers and explore the underlying root causes of their poor performance: Is it poorly negotiated deals with unfavorable terms? Are you exposed to high or unrecovered costs? Are promised volume commitments not being
honored? Compare a low-performing customer with a high-performing one in the same segment and spot differences in prices and costs.

**Invest in automated tools and better data**
Build the case to executive management internally for harvesting and aggregating price information and controllable cost components. Challenge your organization to find a better ROI through investments for equipping the enterprise to make more informed pricing decisions. Keep in mind that the data you want to collect may require business process changes to generate and capture the additional information. Once you begin, build and follow a phased plan to continually upgrade the information available to the pricing, sales and marketing teams.

**Focus on the biggest controllable steps in the price waterfall**
Begin with your largest and most available buckets such as on-invoice discounts, rebates, allowances, and focus on developing price waterfalls. Most of your pricing leverage exists in a few buckets, so it’s better to go deep in a few controllable areas rather than trying to achieve absolute precision in all buckets.

*Figure 1 PROS Pricing Tools for Profit Visibility*
PROS provides pricing software tools that incorporate scientific analytics to automate the process of identifying price outliers and low performers, help determine root causes of poor profit performance, and plan corrective action.

**Profit Visibility in Scientific Analytics**
- Find price outliers and low performers
- Determine root-cause of poor performance
- Plan corrective action
Challenge 4: Failure to Align Price with Value

Without a proper alignment of price and value, it’s difficult, if not impossible, to make pricing decisions that continuously maximize profitability. Because pricing in the chemical industry is very transparent, price decisions are often made on finer points. You need to incorporate customer value points into your deals. It’s a common misconception that value opportunities only occur with specialty products, so don’t fail to consider your commodities as well.

Segment your customers
The essence of strategic pricing starts with customer segmentation that recognizes differences in value perceptions and motivations among groups of like buyers. To perform this “behavioral segmentation,” begin with three or four groups reflecting the relative strategic importance of the customer to your company (A-B-C-D). Overlay the key decision drivers – minimum specifications, joint solution seeker – with these groups to define a manageable number of segments.

Tailor offering levels by segment
Create product or service tiers that align with each segment, adding or removing price and features in proportion to their needs and willingness to pay. Examples may include guarantees, payment terms, freight allowances, contract duration and technical support. Consider offering low-value flanking products that appeal to price-sensitive customers, and include fences to prevent customers from negotiating for high-value offerings at low prices.

Sell your value story relentlessly
Invest in developing compelling ways to tell your value proposition story since the financial returns generated by an informed sales team and customer base are significant. Begin your value selling efforts internally – with the sales force. Educate and train your sales team on how to develop discussions with customers that define price-value trade-offs during contract negotiations.

Engage pricing and value experts early in new product development
The ideal time to align price and value is early in the new product development (NPD) process. Leverage tools such as economic value estimation or customer value mapping to strategically determine target price and feature levels based on market opportunities. Price should drive cost. Design your price first, and then determine the underlying cost position required to achieve internal margin objectives.
Challenge 5: Inability to target prices

Without a precise way to target prices, you face an uphill battle in maximizing profitability. Many companies today still use spreadsheets, databases, paper reports and analysts to help drive pricing decisions. Unfortunately, the world is too complex and moves too quickly for these traditional pricing techniques to work effectively.

Beyond analytics, get prescriptive

Scientific methods can be used to further refine the segmentation by utilizing proven statistical techniques. Furthermore, the science can recommend target prices for each segment. Pricing science using automated software tools removes the guesswork from pricing and helps you create an accurate picture of how your customers and products need to be priced. Analytical tools only describe behavior – pricing science tools prescribe it. By using prescriptive pricing, you can provide direct, timely pricing advice to field and central sales representatives that maximizes profits and actually increases customer satisfaction and your chances of winning deals.

Work both aspects of customer segmentation

Effective segmentation and price targeting must consider both qualitative and quantitative information that you can act on. Both complement each other, and you need both to be successful.

Behavioral Segmentation (Challenge #4) is important because buyer behavior dictates the structure of the offer, and you need a strategy to put these offers together. Scientific Segmentation (Challenge #5) gives you a perspective on the data, and provides a way to scientifically spot patterns in situations that humans don’t pick up on. It also provides precision to the price.

Challenge 6: Inconsistent Pricing Decision Rules

Lacking a shared set of deal evaluation criteria, far too many chemical manufacturers rely on ‘wild west’ pricing. Once you have the basic information you need by meeting the challenges discussed so far, you can begin implementing leading practices. This is the best way to operationalize the cumulative insights gained from identifying low-performing customers and products, defining value points for customer segments and executing better prices.

Implement price guidance for each segment

You need to target prices precisely for each customer segment. This helps bring control and more rigor to pricing decisions you make on a daily basis. There are many kinds of pricing decision rules you can define and use. One is to specify the target, floor, and stretch prices for each customer segment and communicate these to the sales person when negotiating with a customer. Another is to establish minimum margin targets.
for new business, and you can further support the negotiation process by providing profitability analysis on the deal. You can create and enforce an approval process, which ensures that the person with P&L responsibility gets to sign off on the prices and terms before the customer sees them.

Global Chemicals Firm Standardizes Pricing Process to Boost Margins

Pricing to maximize profitability was a particular challenge for this global chemicals company with multiple subsidiaries and customers in more than 200 countries. Inconsistent internal pricing processes often led to conflicts among internal groups. Ad hoc pricing processes, along with non-aligned corporate and field sales policies, characterized pricing strategies and execution. Without a common set of deal evaluation criteria for all customers and contracts, non-compliant invoices were routinely approved.

The chemical company’s sales organization was unable to truly understand the contribution margin of a given deal or customer, and, as a result, often left tens of millions in profit on the table.

Implementing PROS pricing software enabled this chemical company to:

• Provide visibility into pricing data by customer, product, and other attributes that executives, product management, sales, logistics, and finance groups needed to make better pricing decisions
• Replace an outmoded pricing system to enable marketing to standardize methods for constructing product prices
• Assure the latest pricing would be readily available in the field so that sales representatives could quickly and easily execute more profitable price changes
• Deliver complete integration with SAP ERP, coordinating different technical services to roll out the solution to all business units seamlessly.

As a result of these new, automated pricing processes, the chemical company was able to:

• Identify underperforming products and customers in only 17 days
• Take corrective action to increase gross profits by tens of millions of euros in the first year
Many companies today still use spreadsheets, databases, paper reports and analysts to help drive pricing decisions. Unfortunately, the world is too complex and moves too quickly for these traditional pricing techniques to work effectively.

**Get started by examining customer data and establishing a pilot program**

In summary, there are a variety of ways to attack each of the pricing challenges faced by chemical companies today. Utilizing pricing software helps instill pricing best practices in an organization, and also helps automate, speed up and sustain the process.

You can start by creating price dispersion charts and analyzing why certain customers are receiving given prices. Begin the discussion with sales management as to where there may be opportunities to target better pricing. Work with your finance department to examine costs and understand individual customer cost-to-serve. Create a customer P&L which can be used during business reviews and during negotiations with new customers. Also, check customer contracts for compliance with revenue and volume targets, and look for instances of “cherry picking.”

Develop a pilot pricing program that targets two or three markets or geographies areas led by your more strategic-thinking sales leaders. Seek out the help of those who “get it,” and drive them to success. Work closely with your field reps to refine and then test your new set of decision rules. Look for ways to instill better negotiation and value-selling skills. Consider further segmenting your customers. Make sure you have active feedback loops in place to gather insights into how the process is performing. Then build upon the momentum of those early successes.

To learn more about PROS prescriptive software solutions visit our website at www.prospricing.com or contact us at info@prospricing.com.

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