'Set the Price' vs. 'Get the Price' as an all-encompassing overall concept

Service Parts Pricing 4.0
A comprehensive concept for setting and realizing prices that are in tune with reality!
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Price setting vs. price realization: 
What we can learn from tourism

Mallorca: The lovely island in the Mediterranean is the holiday destination for around 11 million tourists a year, 80% of them in the hot summer month of August. These people’s thirst for cheap alcohol and the raucous beachfront bars that serve it have gained legendary status over the years, many a would-be entrepreneur has been enticed to leave their stressful life in the cold of central Europe to get rich quick under the southern sun with their own pub catering to the needs of the package tourists.

But these ambitious newbie restaurateurs, publicans and hoteliers often have an overly idealistic view of life on Mallorca, and end up getting a sobering reality-check. The island’s government and tourism authority have also had a fanciful dream for some years now; of high-priced golf tourism with wealthy punters paying a fortune for a cappuccino in glamorous yacht marinas; of an environment benefiting from a smaller number of tourists and of nature-loving holidaymakers that hike peacefully through isolated mountain regions, bringing their money with them and creating jobs in the premium price segment.

Yes, for many years now, Mallorca has been trying in vain to execute higher prices, with any number of different concepts.

Large sums have been invested in recent years: new roads and hotels built, old ones upgraded and prices in general hiked to the max to scare off the undesired booze-and-budget tourists. On the infamous bathing beach Balneario N°6, that Germans know as ‘Baller-mann’, the authorities have outlawed the previously celebrated use of buckets and yard-long straws for gang-guzzling sangria, and more police are now on the beat there to ensure that the inebriated tourists keep at least a minimum of clothing on.

The Mallorcan tourism office even introduced a tourism tax in July 2016, of a laughable 25 cents to 2 euros per day and per tourist. More wasn’t possible because the long-established, financially satiated hotel owners fought it tooth and nail, claiming it would frighten off their clientele. Younger, more modern-thinking hotel operators revamped their buildings and raised their prices, because the investments required to turn 3 stars into 4 and appeal to the more desirable guests have to be recouped somehow. All this in the hope of attracting ‘better’ guests, realizing higher prices and generating more sales and profit!
So nestled between massive concrete hotel complexes, you can now find charming new guesthouse gems whose hopeful owners have intensely puzzled over the prices they want to charge for overnight accommodation and how they should price their breakfast buffets. No detail about the future patrons and their needs and wants has remained unanalyzed. But what many underestimated was the power of reality, i.e. the fact that the future 4-star holidaymaker would still be surrounded by boorish rednecks, that the promenade on the Playa de Palma still only houses the most basic of French fry and pizza restaurants, that even in one of the largest and most beautiful coves on the island people bask towel on towel and the whole environment of booze-induced conviviality and Anglo-German proletarians will keep the tree-hugging golf player from visiting this Mallorca.

What is particularly tragic about this is that the halo effect well known from market and advertising psychology means that the product as a whole is perceived on the basis of a small number of aspects. The Ballermann tourists barracked in just a few square miles of real estate rub off on the image of the entire island, 99% of which does actually offer peace, quiet and natural beauty.

The customers’ perception heavily restricts the pricing opportunities, and the possibilities of actually realizing the envisioned higher prices are thwarted by innumerable peripheral factors that have to be evaluated realistically in advance. If a tourist can get a two-week holiday with flight included for 299 euros, the more exclusive hotel next door charging 799 euros will inevitably have trouble filling its rooms.

For this reason, the few holidaymakers who can be convinced to take the better hotel are given big discounts at the travel agency and when they arrive even more price cuts for special dinners and daily lunches. On some days, alcoholic beverages are free with meals, waiters are offered high sales commissions so that they take extra special care of the few patrons, and the best of them are given generous bonuses so they don’t leave to work in the luxury restaurants. Suppliers demand immediate payment for fresh goods – without cash discounts. And at the end of it all, the hotel goes bust and the next ‘hotelier’ comes in to seek his fortune.

Reality catches up with the ill-fated hotelier whose pricing is rigidly based on the business plan and the need to recover his high investments. The prices he has to charge cannot be realized because many factors, conditions and influences are not included in the calculation. He failed to consider discounts, bonuses and expensive free extras, and they gnaw away even further at the already meagre sales.

What is the main problem? No coherent overall concept. All the individual activities do not on their own make a concept. The focus was set on what we will call ‘Set the Price’, while the possibility of actually getting people to pay it, or ‘Get the Price’, was not adequately considered. And that although it is at least just as important as determining a
strategic positioning. ‘Get the Price’ entails considerations from the real world: what discounts are needed in order to be able to compete? What regional differences have to be considered? How is the competitive environment structured? What cross-selling benefits can be sourced? Can hotel operators who also run a restaurant sufficiently fill the latter with hotel guests, enabling them to attack the accommodation market with prices that would otherwise ruin them? What influence do higher prices for food and drink have on the hotel’s primary business, the number of overnight stays, etc.? What interdependencies are there between the core business and the peripheral business? So many questions!

But this isn’t a problem specific to the tourism industry, it serves merely to demonstrate the difficulties of pricing that apply to industry in general. Because the makers of nearly all products are faced with similar issues. Construction machines, tractors, large-scale plants... virtually all OEMs are faced with the conflict between ‘Set the Price’ and ‘Get the Price’ – and more often than they know.

An OEM for motorized garden appliances: Uncontrolled price reductions and a lack of cost monitoring inadvertently led to special motor oils being sold at below cost price to an importer in Poland. The number of units sold leapt far above the expected market requirement, while the below-cost price remained undiscovered because only the total sales of service parts was analyzed, and this was seen as flourishing. Not until the sales are broken down to single article level can the problem be seen. Interestingly, the motor oils make up 30% of the sales of service parts in Poland, whereas in other regions they account only for an average of 7%.

The selling of the motor oils at below cost price in Poland led to a total profit margin of 0% across all service parts. Some articles were even well below zero, while in other regions their margin was more than +20%. The location near the border further increased the sales, and hence the loss, because many Germans only had to drive over to Poland to buy cheaper than from their normal German dealer. So unprofitable sales even ate away at profitable sales.
Summary for those in a hurry:

If you were to ask businesspeople whether they would deliberately forgo sales and profits, not one of them would say yes. But that is de facto what happens if you do not have a concept-based price strategy! Many OEMs today do their pricing by the seat of their pants.

Consciously differentiating between setting a price and actually executing it on the market is the first step toward an effective overall concept that leads to higher sales and better margins. Companies today still put 80% of their energy into abstract pricing, but they don’t give actually pushing those prices through on the market nearly the attention it deserves, although that is such a crucial part of the whole process.

Many a company pays a high price for what it thinks of as saved effort early on, because once price signals are made, it is difficult to revise them.

The perfect coordination and combination of ‘Set the Price’ and ‘Get the Price’ in an overall concept, on the other hand, ensures forward-thinking companies much higher sales and profits than the customary procedures often based on rules of thumb, intuition or the extrapolation of data. But how does one proceed? What criteria have to be taken into account? Which mathematical models are used? Read here how a coherent overall concept secures the lasting success of a business.
So the price set is not the one actually realized on the market. The sale price is far from the amount that goes into the cash register. And what is more, there is a big difference between a price calculated roughly based on the cost and a profit margin, and the one achieved with a comprehensive overall concept. The former recuperates the costs and earns a small profit. A good overall pricing concept wants much more than that! Smart, conceptual pricing for products, service parts, etc. also has the intention of reinforcing competitiveness over the long term, optimizing earnings/profits and securing customer loyalty. But what is the reality in many companies?

- An OEM for heavy machinery: Two special screws with very similar form and function but minor size differences are sold to the same customer at prices that differ by a factor of five, leading to enormous customer dissatisfaction. As the customer sees things, it is paying 2 euros and 10 euros respectively for two identical screws. This wouldn’t be relevant for just one screw, least of all from a monetary point of view, but minor details like this can deal a hefty blow to the customer’s confidence that there is a fair price model behind in place, especially among those customers that don’t only buy one screw for
two euros, but instead generate many millions of euros in sales with all kinds of spare parts. The feeling of paying too much for some parts has a negative effect on the customer relationship and the customer’s loyalty over the long term.

- **An OEM for agricultural machines**: The good negotiation tactics of a wholesaler lead to such an imbalance of discounts that the wholesaler can offer some service parts to the end customer at below the retail price. This is particularly troublesome, as the retail sales channel is actually the one preferred by the OEM, because the retailers are the technical service partners. This not only repeatedly leads to fully justified complaints from retailers, it also leads to a risk of self-cannibalization! What is more, the OEM and its retailers have lost their pricing authority – with fatal consequences for future pricing!

- **An OEM in the high-tech industry**: Service agreements that insure against the malfunction of replacement parts are often sold at a price more than 450% higher than the average price of the defective parts. As the customers are well informed about the probability of breakdowns and the prices of replacement parts, these agreements do not find any buyers, despite the fact that they are a win-win situation: for the customer an insurance policy and for the OEM a means of binding customers and assuring simplified connectivity. If they were to offer these agreements at sensible prices – for instance at 200% of the spare-part price – the customer would be more willing to pay the mark-up, because these parts are very expensive at up to 50,000 euros each, while the probability of their suffering a defect is only between 1 and 3%. Conclusion: Prices for spare parts and service agreements have to be adjusted to each other and well balanced, otherwise credibility can be lost and with it business.

Unfortunately, these are not unusual or extreme examples. Similar weaknesses in the pricing of service parts are symptomatic for the manufacturing industry and come to light as soon as pricing and discounting practices are subjected to close scrutiny. The companies are continuously faced with a never-ending task of launching, producing and selling new products and devices.

Because competition is tough in this primary market: markets shift, technology develops, competition increases and profit margins crumble. So it comes as no surprise that companies invest so much in strategies, processes and IT to ensure the sale of their primary products. Nonetheless, the true promise of profits generally lies in the field of service and replacement parts for the care and maintenance of these products and devices. On average, the service business accounts for about 20% of the total sales, but up to 60% of the profit!

Despite this, the ratio of employees who work on the pricing of service parts to those employed in the primary business is about 1:20. In many cases the
The pricing of service parts is in fact a complex task, and various elements and influential factors have to be taken into account when developing a successful price model:

The pricing of service parts is only a minor responsibility of a single person in the Logistics department.

Automobile manufacturers such as BMW, which has more than 20 pricing experts for service parts, are a rare exception.

Because of much higher earnings margins, the need for and opportunities offered by investments in this area wrongly appear to be insignificant. Why? The earnings margins are already relatively high, so many companies don’t think about further potential. Being satisfied with relatively high profits stops companies from getting even better, identifying the true levers and fully exploiting the margins available to them with an optimized pricing concept that covers many thousands of different spare parts.
Many companies invest a lot of time, money and manpower into determining prices; they put a lot of effort into defining individual prices within a replacement-part portfolio. In doing so, they often fail to design a balanced and well-thought-out overall policy for pricing their replacement parts – with far-reaching consequences:

- Major losses in sales and market share while not fully exploiting the profit potential of service parts
- Dissatisfied sales partners and a loss of customer loyalty
- Cannibalization caused by the unintended creation of new options for wholesalers, procurement organizations, the gray market and makers of clone parts
- Negative influence on the sales of the primary products – overpriced parts compromise the total costs across the service life

The main conflict in the overall pricing concept: ‘Set the Price’ vs. ‘Get the Price’

These introductory examples expose deficits in both the setting of prices (‘Set the Price’) and their execution on the market (‘Get the Price’). This is where the main conflict manifests itself, because there is often too little concept behind the defined prices, leading to enormous forfeited earnings.

On top of this, discounts make it difficult to actually realize the price on the market anyway, further lowering the sales being generated. A typical example from consulting practice: Head office prescribes a price that has been determined more or less from gut feeling based on just a few factors. This price virtually ignores regional differences, interdependencies in the customers’ purchases and the criticality of the parts. Dealers in some countries have enormous competition, others do not, and yet the prices are identical. In some regions the dealers offer large discounts to boost sales, especially in those countries where the dealers are incentivized solely on the basis of the number of units they sell instead of the profit earned with each part. The result is that the sales and earnings of the entire replacement parts activities remain well behind their potential.

Successful pricing, on the other hand, addresses the entire process, from the centrally-prescribed price to the actual enforcing of it at regional level without central control.

‘OEMs put more than 80% of their energy into trying to find the ‘right’ price, but lose sight of how they intend to execute the price on the market, which is just as important. Here, only a well thought-out comprehensive concept can lead to the optimized exploitation of the entire price potential. The lack of such a concept means the loss of sales and profits!’

(Quote from Dr. Andreas Baader, Managing Partner Barkawi Management Consultants)
The graph above depicts the duality between setting and getting prices, and shows that there is complexity in particular when it comes to executing prices, and that uncontrolled price execution inevitably leads to a loss of margin.

This means that if they don’t look out, companies can lose a lot of money, market share, client loyalty and more!

"Our head office defines the purchase costs and then adds an 80% mark-up. But then 50% of the price gets lost again after the sale and we end up with less than what we paid’

(Quote from employee international OEM)
In many cases, prices are initially set on a ‘cost plus margin’ basis using the overhead calculation, cost plus or similar methods, totally independent of the market environment. A price is nailed together made up of the purchase costs, the material value, staff and logistics costs or fixed and variable costs, and it rarely takes the bigger picture into account.

Instead of this kind of pricing using trivial mark-up factors, one could use a much more intelligent, analytic, conceptual system that initially appears to involve a lot more work, but that will ultimately pay for itself many times over! Well-conceived pricing is based on three basic principles that are equal in importance and applied simultaneously:

**Principle 1:**
Segmentation and portfolio structuring

**Principle 2:**
Margin curves and pricing rules

**Principle 3:**
Factors that influence price satisfaction
Principle 1:
Segmentation and portfolio structuring

Parts segmentation and the structuring of the parts portfolio are central to mastering the complexity of pricing. Key success factors here are the categorization of the parts in terms of how competition affects them, and thinking in terms of value drivers. Competitive endangerment refers to the degree to which the part in question is different from parts offered by competitors: is it a standard part with various different providers on the market? Are the competitors’ prices easily available and can they be easily compared? Is the part specific to the OEM, perhaps even with property rights attached? Is it a ‘captive part’, standardized or ‘competitive part’? Captive parts play a very special role here: with these the OEM has a quasi-monopoly on the part, giving it a strong position on the market and enabling it to dictate the terms and price. The OEM can make the price for a captive part unattractive for independent repair businesses and cheaper for certified dealers, which helps bind customers.

A typical example of a value driver is ‘criticality’: How critical is the part for the customer? Does a defect in the part lead to a standstill of a piece of equipment, and perhaps lost sales or even penalty payments? Or is the part not all that crucial, only important for the appearance, simplified use or extended service life of the equipment? These criteria enhance the potential for profit margins and are decisive when selecting the most suitable pricing approach.

For instance: the malfunction of a Teflon bellow worth about 40 euros in a bottling works can quickly lead to 8,000 euros of standstill costs for a beverage manufacturer.
**Principle 2: Margin curves and pricing rules**

**Glossar**

**Captive parts:** Here, an OEM is the sole provider and has a quasi-monopoly due to special rights, intellectual property rights or unique technical abilities.

Common practice, however, is to add the same profit margin to all parts, although in some market situations it would be wiser to adapt prices to the market and offer inexpensive prices. Asking high prices for parts for which there is a lot of competition leads to a loss of market share. Not fully exploiting the price potential of captive parts, on the other hand, is a lost opportunity.

An example from the agricultural machinery industry: The usual mark-up factor of five invariably leads to losses of market share with parts like filters that are readily available on the market and that the competition offers at 1.5x, whereas customers would accept factors of up to 10 for certain captive parts, without any loss of turnover to the OEM. Charging a factor of five although up to ten would have been obtainable means an enormous loss of sales and profits, and that merely because the price was set way too low due to ignorance of the market situation in this segment.

Pricing that adapts to the market is generally the right method for parts subject to strong competition, because it secures market shares. Here, the prices are set in full awareness of the prices being charged by the competition. The overall margin can be increased using value-based pricing that exploits the competitive advantage of captive parts, because the OEM has a monopolistic position and more pricing freedom.

When it comes to finding prices for tens or hundreds of thousands of different service parts, the process will always be defined by rules. Nonetheless, even using clearly defined pricing rules is far superior to simple ‘cost plus’ pricing. But what does that mean in real terms?

**Pricing algorithm: Mathematics isn’t everything, but without it, everything is nothing!**

A mathematical view finds the correlations and maps the individual functions onto a curve. For example, customers tend to be less price sensitive and more willing to pay for low-value parts than for high-value parts or main components. As the part value rise, the customers start thinking more about price and value. They compare the price with the residual value of the equipment, research prices and look for alternatives. So segment-specific margin curves with falling margins as part value increases are a useful basic rule.
In the next step, additional mathematical rules can be superimposed over the proposed price as generated by the margin curve, i.e.: if a higher price can be obtained due to the market situation and its dynamic evaluation, strictly applying the margin curve would cost margin. If a higher price is already well established and accepted by the customers, it would mean foregoing profit to use the price suggested by the margin curve.

The mathematical rule that can be derived from the margin curve may, therefore, have to be questioned and ignored if it leads to a disadvantage, for example because it demands ‘restricting the price change to +/-20% of the current price’, ‘alignment with market prices for competitive parts’, or rules that create price consistency among easily comparable parts such as symmetrical parts. An intelligent system is dynamic and extracts the maximum out of a part’s potential, without adhering inflexibly to demands or algorithms!

The true art lies in defining the best or most suitable margin curve for each parts segment, because that requires experience and, to a certain degree, intuition. Some interrelationships are immediately apparent, because the customer is less price-sensitive, has fewer alternatives and more time to make a decision. Margin curves for captive parts can and should be higher than for parts subject to more open competition, and the margin curves for critical parts should be higher than for non-critical parts!
But despite all the supposed quantitative, mathematical precision, one thing should not be forgotten: the decision on the absolute position and gradient of the curve is often made on the judgement of the OEM’s market experts, for example based on observations made in customer interviews and experience from (external) price specialists – qualitative assumptions that in consequence represent the basis of mathematical calculations. In actuality there is no ‘best’ price curve that applies in general to each segment, and an intelligent, iterative mathematical process is required that uses the chosen approach to provide optimal monetary results and increase customer satisfaction levels. The algorithm individually selected for each individual case is the heart of the overall pricing concept.

Although the margin curve approach is similar to cost plus, it is much more powerful. Using dynamic curves instead of static factors makes use of the fact that customers are far less price sensitive when it comes to low-value parts. For example, a plant builder will quite readily pay 4.50 euros for a special bolt that costs the supplier 50 cents – a profit factor of 9. In contrast, for a freely available but high-value part such as a storage unit that costs 1,000 euros, a mark-up of 1.8, or a price of 1,800 euros, is generally the upper limit. Customers are far more likely to look around for alternative providers of high-value parts.

In the same way, differentiating the parts in accordance with competitive criteria and value drivers like criticality, and applying different margin curves depending on the segment in question opens up various alternatives: the respective margin curves are calibrated either in accordance with the market-based approach using market impulses, or on the basis of insights into the customers’ willingness to pay – the value-based approach. But what does that mean in practice?

The core of the insight is that criticality is a value driver that increases the willingness to pay a higher price. A large international maker of forklifts also manufactures warehouse storage systems. If a part is missing in the storage system, the entire warehouse comes to a standstill. Consequently, the customer is more willing to pay for storage system parts than for parts that do not need to be replaced immediately or for which there are alternatives.

A heavily competitive environment with numerous suppliers and interchangeable spare parts makes for flatter margin curves than a heavily restricted market environment. A quasi-monopolist can do as it pleases with its captive parts, exploiting margin potential as it desires, because the customer has few alternatives.
Principle 3: Factors that influence price satisfaction

The use of rigid pricing rules and dynamic margin curves lies in the predominantly mathematical and hence quantative view of things. But the customer’s purchase decision and lasting loyalty are also influenced by soft factors that can be subsumed under the term ‘price satisfaction’.

There are various factors that influence price satisfaction, which if not observed can cause a seemingly well thought through pricing concept to collapse: if a customer’s wife drives the relatively small 1 Series BMW and pays much less for a spare part than her husband does for the identical part for his 5 Series BMW, he can quickly become disillusioned with the perceived price fairness, with far-reaching consequences for his level of satisfaction.

There are a number of lessons to be learned from this example, which can be used to derive the following six recommendations:

The six most important recommendations:

1. Avoid drastic, repeated or ad-hoc price changes!

A rule stored in the system led to a mechanical engineering company raising the price for a certain part from 4,607.50 euros to 8,677.50 euros within the space of a month. The reason for this was that the part was moved from series production to individual manufacture, causing its internal settlement rate to be re-evaluated.

This kind of price change has to be made less striking, for instance by means of a cross-subsidization within the product portfolio, or by allowing it to be balanced out within the buyer portfolio. Another option is to accompany the price increase with a communication package, so that the customer understands why the price was raised.

The goal is to prevent being perceived as expensive due to individual prices that are not representative of the overall product range, and to avoid being seen as having an arbitrary or untrustworthy pricing procedure.

2. Be sure to keep in particular captive parts reasonably priced.

Offer what the customer deems to be fair prices. Excessively high prices and the obvious exploitation of monopolistic situations may increase short-term profits, but over the long term they are counterproductive.

Various automakers got into trouble with the Chinese antitrust authority because of overpriced replacement parts.
For example, the price of a Mercedes C Class put together entirely using replacement parts would have cost 12 times as much as the new vehicle. If figures like that make the headlines, it is a major media disaster for the company, and it delivers a devastating blow to the customer confidence that it has taken years to build up.

3. **Consciously make attractive prices for a small range of products to influence how customers perceive your price level.**

As a rule, service parts elicit a very strong 80:20 Pareto curve. This means that although there is a wide diversity of parts available, most of the sales are concentrated on a relatively small group of them.

For a manufacturer of agricultural machines, 755 of a total of almost 100,000 parts account for 80% of the company’s sales, and just 15 parts are responsible for 20% of sales. Setting attractive prices for these 15 parts in a pricing project significantly improved the customer satisfaction, despite the fact that the overall price level was increased.

That is what is known as a win-win situation! Here, the halo effect meant that the fair pricing of 15 parts radiated out across the entire product range, leaving a decidedly positive impression on customers.

4. **Make sure that prices appear to have a plausible pattern.**

Some ill-considered pricing decisions prove to be irritations with far-reaching consequences: If the customer pays less for a part in red than for the same part in green, or if the part on the left is much cheaper than the one on the right, or if the successor part is much more expensive than its identical predecessor, the customer often suffers from a feeling of arbitrariness that is tough to get rid of. What a shame, because often only a few euros more are earned in the process, while a customer’s trust is invaluable and difficult to rebuild after such a blow.

So the objective is to try and give symmetric parts (right/left, front/back) and parts that are identical except for their color the same price. Price consistency is just as important for predecessor/successor parts, for comparable parts in different sizes and for comparable parts from different product lines.
This is the only way to ensure that customers will perceive the pricing as transparent and fair. And this perception – often irrespective of the actual price level – is what founds customer satisfaction, customer loyalty and customer confidence! (see also the chapter 'Communication')

5. **Base your prices on what your customers consider to be the total costs!**

The price of a product as offered by the manufacturer is often not the same as the way the customer perceives the overall cost. This can be explained using the example of purchasing an automobile: The manufacturer views its sale price as a purchase price, and hence as a decision-making criterion for the customer. But that is not the whole story, because the procurement costs are only a small part of the customer’s total costs, and hence of the decision-making criteria. Costs of maintenance, servicing, regular care and fuel are also part of the customer’s considerations. Cars in different price classes often have varying mileage, resale value, maintenance intervals, wear and tear on moving parts, etc.

The mileage has a significant influence on the additional costs. Insurance and taxes also vary according to the model and size of the vehicle. Then there are fuel, tire wear and tear, brakes and clutch, all of which add up to relevant costs for the customer and have to be added to the total costs related to the mileage – the ‘total cost of ownership’. These costs relativize the acquisition costs.

OEMs should take this into account when setting their prices, in order to ensure that they do not act in contradiction to the customer perception as a result of only considering the pure purchase price.

A plant manufacturer reports that customers are building up ever better proprietary databases, so as to make total cost of ownership observations and use them in price negotiations. So prices for replacement parts are already important at the purchase of the primary product and are analyzed systematically in advance. OEM’s have to understand and anticipate this!
6. Individualize your prices according to the customer type.

Automakers often offer identical parts at different prices for different product lines – c.f. the example at the start of this chapter, in which the husband, a driver of a premium-class sedan, takes his wife’s small car in for servicing and pays a lower price for the same part for his wife’s car than he paid for it for his own car. Normally this happens inconspicuously, as a database is running in the background.

The prices are displayed in the system upon entering the vehicle number. In this way, the price for the premium product line can be upheld, while owners of a standard product are also offered an appropriate price.

Summary:

Pricing is much more than just ‘cost plus’! Every forgotten detail, every consideration not made when pricing the product can come back to haunt you, with sales and earnings potential not being fully exploited.

In addition, you open up the field for other competitors who do a better job, and once disappointed or angry customers are lost, it is almost impossible to win them back. The creative energy invested pays for itself many times over!

This said, smart pricing is not everything; but without it everything comes to nothing. ‘Set the Price’ is the foundation upon which a clever ‘Get the Price’ concept is built.

Nonetheless, pricing is at best only half the story, and in most companies even less than that, because the problems start upon entering the market with a predetermined price! Which problems? The problems that make life difficult for OEMs, despite having set prices, because there is often a huge discrepancy between theory and practice that we know as reality!
In the real world, the well thought-out and carefully calculated prices meet up with demanding customers that threaten to change to unfair competitors that enter the market with lower prices, with dealers that want to poach business and any number of other nasty tricks that cost profit margin if you close your eyes to the facts and forget to consider them in the pricing process!

Even the cleverest pricing concepts are useless if the margins cannot be exploited in practice. Three major weaknesses in price execution, in which risks and opportunities face off, can be systematically observed:

**Risk vs. Opportunity 1:**
Local pricing – Regional prices do not adhere to centrally determined price standards

**Risk vs. Opportunity 2:**
Discounts and terms – Margins are melted away by discounts and offered conditions

**Risk vs. Opportunity 3:**
Downstream bonuses, rebates, commissions, discounts and promises of free service generate costs that often cannot be foreseen and therefore are not taken into account when pricing.

**Mission 3.0:**

Optimized price execution

‘Get the Price’
During a price project for a maker of agricultural machinery, it became apparent that a number of fast-moving service parts weren’t selling as well in the north-east of Germany as in other regions. The prices in Poland were so much lower that a gray market had established itself for these parts between dealers in Poland and north-east Germany. The local competition from imitation parts had induced the Polish branch to lower its prices for these parts in order to remain competitive and not lose market shares, but it hadn’t anticipated the risk of cross-border trading. German customers soon began buying their replacement parts in Poland as well. In this case it would have been better to simply accept that there was strong local competition in Poland, instead of ruining the company’s chances in the neighboring markets and cannibalizing itself.

There will always be gray markets when price levels vary, but what figures, data and facts are to be expected has to be considered. A calculation model can be useful here. And it can get even worse: If the Polish dealer loses its sales to the competition despite cutting its prices, the loss to the company is doubled, having sold at lower prices and then not selling at all!

There are good reasons for regionally varied pricing, e.g. varying customer willingness to pay, the competitive situation or differences in the related service costs. For instance, in Scandinavia higher prices can often be obtained for service parts than in Central Europe. Customers there are generally used to paying slightly higher prices, and there appears to be widespread acceptance for paying an additional premium to cover higher service costs. On top of this, manufacturers of generic products are usually less prevalent there. But barriers between regional markets do not remain. Regional price differences always provide motivation to trade across borders, at least as long as the price difference is greater than the handling and logistics costs involved. The expected benefit of regional price differences has to be weighed off against the risk of a gray market.

One pragmatic solution is to determine regional premium and discount factors for all parts, in order to derive regional list prices from central ones. These regional factors take service costs into account (logistics and import duties), local market circumstances (competition, currency risks, wage level) and customer behavior aspects (e.g. price sensitivity and service orientation). In addition, a limited list of parts is defined for which the local price can react to market requirements within a predetermined range. Price deviations for other parts or outside this bandwidth have to be approved by the central pricing team. What we are talking about here is ‘freedom within a framework’. Another manufacturer in the same industry had the problem that different regional sales companies were offering the same internationally active wholesaler varying prices,
enabling the wholesaler to benefit from arbitrage. This could even have worse consequences if the wholesaler were not only always to buy from the cheapest provider, but also to play the sales companies off against each other, pushing the prices down in a spiral. This kind of case has to be dealt with by central customer management!

Fundamentally it can be said that local prices are a risk and an opportunity, depending on the individual case. But this requires active management of the local prices; acting instead of reacting. Only then can risks be assessed and turned into opportunities!

**Risk vs. Opportunity 2: Discounts and conditions**

Discount and condition patterns describe how invoice prices are derived from list prices. Typical discount types are basic discounts per customer – e.g. by customer group or negotiated individually – volume discounts, discounts depending on the type of order (e.g. express versus standard order, internet order, etc.), seasonal discounts, special promotional campaigns or discounts negotiated on a transaction basis. The conditions encompass additional charges such as forwarding costs or payment terms.

As already mentioned above, customers differ in how willing they are to pay certain prices. If one can segment customers according to their readiness to pay, discounts are one way to optimize margins. But customers can also make varying value contributions to the value chain as a whole.

In a dealer network in which the dealers are the OEM’s primary customers (i.e. not the actual end customers as is customary), loyal and certified dealers are important partners for selling service parts. These trading partners provide the end customer with a premium service, while uncertified dealers play a less important part in sales and service because they are generally smaller, sell less and don’t as a rule sell the primary product as the certified dealers do. So they offer general service and repairs but not the sale of the primary product. OEMs bind their end customers to the dealer by having it sell new equipment and offer the applicable after-sales service. That is just what the uncertified dealers do not do, so they are clearly to be prioritized below the certified dealers.

Wholesale dealers, on the other hand, are often key partners in the selling of service parts but don’t offer service themselves. Discounts are ideally calibrated in such a way that they account for the different roles played by the various dealer types.
So, for instance, a wholesale dealer gets a discount of 36% from an agricultural machinery OEM for freely available parts subject to wear and tear, and the premium dealer gets a discount of 30%. As a rule, the customer itself installs these parts, and both the wholesaler and the premium dealer act as distributor, with the wholesale dealer serving the end customers via a network of smaller traders, each of which requires a margin, and the premium dealer selling directly to the end customer.

What is most important to the OEM is keeping the market share of alternative providers low. Wholesale traders are given a bigger discount because of their market power and their higher sales volumes.

In contrast, the wholesale dealer only gets a 20% discount for captive repair parts, while the premium dealer gets 25% – the dealer installs these parts when doing repair work. The premium dealer ensures that a premium service is offered, and in return it should be able to buy these parts at a good price. In the case of the wholesaler, smaller, unauthorized dealers or technical companies buy the repair parts, and they should not be given the parts at a better price than the premium dealers.

A well-designed discount system addresses all sales channels and customer types, and can be used effectively as a tool for managing and incentivizing sales. But nearly all customers are exposed to the risk that even well-conceived discount systems degenerate over time, e.g. due to an increasing number of exceptions or the people responsible for sales not adhering to the discount policy.

A current example illustrates the problem: A manufacturer of motorized garden appliances uses an elaborate discount concept that differentiates
discounts by dealer and customer type, and by part group. In this way, discounts for captive replacement parts that are usually only ordered if a device or machine breaks down can be differentiated from fast-moving wearing parts that are exposed to tough competition and ideally should be held in stock. This incentivizes the selling of wearing parts, while at the same time good profit margins are achieved for captive replacement parts.

Over time, however, new customer types and part groups were added, and the discount system ultimately contained 12 customer types and 52 part groups, resulting in a discount matrix of 12 x 52 = 624 entries that needed managing. The system became far too complex, and when the manager in charge of it was changed, the initial logic used to determine the discount level could no longer be understood.

This matrix was reworked in a pricing project and returned to a discount system with only 9 customer types and 12 part groups. An easily comprehensible logic was developed in a kind of cube, for how discounts were to be calculated per customer and per combination of replacement parts, and this could be communicated easily to customers. Now customers know why they are getting a certain discount for one part group and not for the other, and they also know what they have to do to obtain a better discount.

Another agricultural machinery OEM used a discount system that initially stored an individually agreed flat discount rate for all parts. The customer account managers were given guidelines for granting discounts.

Data analyses showed, however, that they interpreted these guidelines in different ways, and the discounts granted varied greatly between the managers. In addition to a basic discount there were also six other discount options for the customers, which could be combined with each other. The result was that discount optimization became a complex art form for the customers and pricing became unnecessarily complex for the organization.

A further challenge was that the system of transport cost surcharges gave rise to serious customer complaints. During an intense phase of customer interviews, it became apparent that competitors in the wholesale field were offering express delivery
for a one-off annual payment, while the manufacturer itself was charging transport costs for each standard order, and even higher ones for express orders. Although customers found the overall price level fair, the method for billing transport costs was a door opener for the competition.

These examples show that discounts and conditions have to be understood as an intrinsic part of pricing and that they need to be given the same attention as the determination of list prices. Binding rules for the sales team are an important prerequisite, as is the anticipated granting of discounts by means of early, active pricing-in where this is possible in the competitive environment.

It is no easy task to find a balance between personal freedoms for the sales managers and preventing unrestricted discounting behavior without putting a damper on their motivation. It requires a well thought-out concept and clear instructions.

In summary we can say that discount differentiation opens up attractive opportunities to optimize margins, but can also quickly increase complexity. When designing and reworking discount systems, it is good to remember that once a discount is offered, it is difficult to take it back again, unless the change is accompanied by a convincing communication plan. As a rule, however, uncontrolled discounts cause a manufacturer to irretrievably lose its price authority!

**Risk vs. Opportunity 3:**

*Downstream costs such as bonuses, discounts and other service promises*

An OEM from the high-tech industry offers its customers support through a professional technical call center, laid out in various different service contracts. The call center costs are addressed correctly in the pricing of the service agreements, but at the same time, the same technical support is also made available at no extra cost to customers that buy services and parts as they require without a blanket contract.

This additional support service generates value for the customer and costs for the OEM. It would be ideal to invoice customers without a contract for their use of the call center. But at the very least,
the costs should be incorporated into the pricing process for service parts. Why?

**Special services, discounts, bonuses**

Because different downstream cost effects typically seriously reduce the profit margin after the sale, causing products with a large number of special services attached to quickly reach the limits of their profitability. In order to ensure making a well-considered decision, the decision-maker should always be conscious of the following cost-relevant effects:

- **Discounts:**
  
  Sometimes customers negotiate discounts that cannot be seen on the invoice, such as bonus parts or discounts for cash;

- **Bonuses:**
  
  Sales staff often receive bonuses;

- **Free support:**
  
  Services in combination with the sale of service parts are often not billed, such as technical support, remote services or express delivery;

- **Rebates:**
  
  Customers receive a rebate at the end of the year that increases with the volume purchased during the year.

A set of rules for controlling these effects is just as much a part of a comprehensive, modern pricing project as is the consideration of all service cost elements during the pricing procedure, so it is far more than just the purchase costs of the service parts.

The human factor is one of the most difficult aspects to gain control of. Sales managers like to bind customers to them with little favors and extras in order to achieve their sales targets, but if the manufacturer were to analyze its total costs, it would see that it sacrifices large amounts of margin if it allows its sales staff to offer free services at will.

It is a well-known fact of modern sales management sales teams are not to be incentivized only by means of sales commissions, but that these commissions should be linked to profits.
A pricing concept that truly deserves the name needs not only clear stipulations for ‘Set the Price’ and ‘Get the Price’, but also an overall strategy! Defining list prices, discounts and conditions alone is no guarantee of success for the service business if it is not embedded in a strategic concept. There are four pillars that form the basis for good pricing that is oriented toward the customer’s perception of the value, the actual costs and the competitive situation:

**Pillar 1:** Valuable products

**Pillar 2:** Customer segmentation

**Pillar 3:** Controlling margin leakage

**Pillar 4:** Communicating the product value and proactive selling
Pillar 1: Valuable products

It goes without saying that product quality is an important decision-making criterion for customers, but not everyone is aware that it is often not enough to simply offer a poorer product at a lower price. The following diagram is based on customer interviews from two different OEMs of wind power plants and shows that price is not the only critical criterion for a purchase decision. As obvious as it may seem, the reliability and durability of the parts and their availability and speed of delivery are at least as important, if not more so. It is rudimentary to create valuable products with attached services and manage innovations and components protected by industrial property rights! These considerations already have to go into the overall strategic concept at the product development stage if the product's success is to be guaranteed. This means you really have to know what the customers’ decision-making criteria are, and not simply act on false assumptions.

Another real-life example: A manufacturer of agricultural machines observed problems in selling special, steel wearing parts. It turned out that the problem was not the price but that a maker of generic parts offered similar parts made of specially hardened steel with a much longer service life. Although the price for the imitation part was higher than for the original, the competitor was able to gain a considerable market share. It can be useful to collaborate with prioritized customer segments in order to develop the best possible product and service offerings that allow a company to charge a premium over the products of other competitors. Here, OEMs work together with preferred customers in workshops and/or with customer questionnaires to find out what makes a product good or what decision-making criteria are important for the customers.

This enables an OEM to avoid missing something important or getting an unwelcome surprise from a new player with what might be a better product.
But the price is not the only important aspect for a customer. The following quotes from the interviews with various different customers of a plant manufacturer show how important availability and speed of delivery of the parts are:

‘Delivery times are a major aspect – criticality and possible production losses are criteria that lead to my company management having no problem with me buying expensive parts.’

‘Apparenty work is being done on a concept for improving prices. We are happy about that of course, but we are willing to pay for quality. Price is not the most important thing. Quality and availability are also key, as our machines run 24/7.’

‘I always buy standard parts from the manufacturer as well. The delivery time is unbeatable.’

‘Machine downtimes are a big problem that cost 6,000-8,000 euros an hour. So then premiums of 30-40% are acceptable for us.’

(Quotes from customers of an international plant manufacturer)

**Pillar 2: Customer segmentation**

The customers of most manufacturers and OEMs differ greatly. Large customers have other needs than small ones, some have a big staff of technicians and solve most of their problems on their own, while others need extensive technical support. Some customers are more willing to accept risk and pay for service parts and premium services. The best way to deal with differing customer needs is to put together different packages with individually tailored services and product specifications.
For instance, a maker of high-tech equipment could divide its customers up into three main groups:

1. **Price-tolerant large customers:**

   This customer group has technical know-how and prefers to buy service parts and technical support when damage occurs or repairs are needed. They are willing to bear the risk of a part breaking down and tend not to enter into service agreements that also insure such part outages, in the knowledge that these agreements include a risk premium. They tend to buy wearing parts that have alternative sources on the market directly from the parts supplier.

2. **Cost-conscious risk-minimizers:**

   These customers tend to be more open for contracts that cover the malfunction of key parts, in order to reduce financial risks. In some cases, they are even required to do so by insurance companies or financing partners. For foreseeable service costs such as parts subject to wear and technical support, they tend, however to seek cost-efficient solutions.

3. **All-inclusive package customers that want help:**

   These customers want full-line service agreements because their limited financial strength means they cannot cover higher risks of down-times and they only have limited capacities to search the market for alternative sources of wearing parts.

Precise account planning and the offering of service parts both on an individual article basis and as bundled components in different service agreements enables all customers to be catered for and profit margins to be adjusted to suit the different customers’ varying willingness to accept risk and pay higher prices.

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**Pillar 3: Controlling margin leakage**

Trust is good, control is better. That sums up Pillar 3 pretty well. Feedback loops for ensuring that requirements are met are essential in order to uncover margin leaks.

Professionally monitoring the overall success and critically scrutinizing at regular intervals professionalizes and optimizes the pricing tool and its mechanisms. So the installed pricing concept and its mathematical algorithm is dynamic and not static.

A good tool lives and breathes and becomes smarter and more efficient with each feedback loop. Because the customer, too, is an active and dynamic entity, and those who gather customer data and requirements once and then rely on them for evermore are lost!
The graph shows the discrepancy between the basic discounts that a maker of industrial machines formally specified per customer and the ones it actually grants. In this case the difference amounts to 9% of the net sales. What happened?

Each bubble in the chart represents one customer. If the actual discount granted for the customer were to correspond with the one prescribed, all of the bubbles would be on the line. Most of them are well above it.

The size of the bubble depicts the sales generated by the customer. If all customers had only been granted the formerly prescribed discount, sales would have been 9% higher. The effect on earnings was even greater, as the 9% more sales affect the earnings directly because they exhibit no further costs.

So carefully specifying rules for the determining of central and regional list prices, discounts and conditions does not guarantee that the pricing policy will actually be adhered to. Incentive systems for sales-people that are not merely sales but also profit based, and loyalty programs help the price policy to be upheld. Control structures are just as important, to ensure the rules are adhered to. Expert solutions for pricing with a cascading key-figure system instead of complex ERP modules with limited functionalities and Excel/Access solutions can help here.

A pricing team that is focused fully on concepts for and the execution of pricing for service parts should be supported by a pricing committee with members from Sales, Service, Finance, Logistics and Procurement. This committee oversees results and helps to continuously improve the pricing processes.

This sounds like a lot of work, and admittedly it does not have much in common with the good old cost-plus pricing system. But it pays to do the groundwork instead of standing by and watching helplessly when competitors later get the better of you because you were too lazy earlier on!
Pillar 4: Communicating the product value and proactive selling

The American Lee Atwater, a political advisor to Ronald Reagan, George W. Bush and the Republican party, was known for his aggressive media campaigns in the 80s, and the catchphrase ‘Perception is reality’. He couldn’t have put it better, because what the customer perceives becomes a statement, or information, irrespective of whether that was intended or not. Or, from the other standpoint, desirable positionings are often not perceived at all, for instance by customers, who possibly see the product in a different light than the manufacturer would like. So it makes a lot of sense for every OEM to carefully consider the information it wants to communicate, and to include it as a component part of its pricing concept.

The price perception ‘expensive’ caused by the miscalculation of a small number of parts can have just as fatal consequences as not communicating key product benefits. For example, the company Blackberry (formerly RIM Research in Motion) could have gained an absolute competitive advantage in a world of constantly falling mobile phone prices: in 2003, RIM was the first cellphone producer to bring out model that supported push e-mails. So Blackberry pretty much invented the mobile e-mail. It didn’t take long before nearly all mobiles offered this service as a standard, and the USP was gone.

But that wasn’t all: absolute data security! This even led to Blackberry phones being forbidden in totalitarian states like China for a while, because it was impossible for the government to wiretap them. But instead of using, communicating, marketing, exploiting this product benefit wherever it could, and including it in the pricing concept, RIM advertised
using various unspecific, strangely maritime motifs that to this day are neither universal, consistent or fitting in the advertising concept.

The objective benefit of being tap-proof that even led to German Chancellor Angela Merkel making all her confidential calls only with Blackberry mobile phones was never communicated to customers. Nobody even registered this absolutely justified argument for paying a premium price, both for the primary product and for the after-sales service and repairs. Data security never even made it into the buyers’ considerations when weighing up which phone they wanted. And for many years now, Blackberry has been fighting against oblivion, because Lee Atwater was right: perception is reality!

And Apple will be next. It has been riding the wave of success for years now with its perception as the highly innovative manufacturer that could justify any price with its products’ stylish image. But clouds are gathering on its horizon too, with sales receding. Before long the image will change, and it will seriously influence Apple’s pricing. Even though its coffers are full and Apple is buying innovative companies, products like Dr. Dre and his Beats headsets with the associated Beats music streaming service that Apple bought in 2014 for 3 billion US dollars will not have as much appeal as the iPhone.

So it may not be long before the Apple brand is no longer perceived as being so desirable, and people will cease to pay its exorbitant prices without batting an eyelid anymore. The pictures of fans sleeping the night outside Apple Stores in order to be first in line to get the latest iPhone still have their effect, but that can be over soon. These images shape global perception, but that is a two-edged sword that can be good and bad for a brand.
So without the right marketing, offering the best parts and services can be a waste of effort. Tell your customers that you are better than your rivals! Your sales team and partners have to be trained to inform customers of your company’s value, and they have to be provided with communication material that helps them do so.

‘Inexpensive’ is a whole other concept than ‘cheap’! But if the customers aren’t aware that they are getting a premium delivery service, for instance, how can they appreciate the value of it? Do good and talk about it!

A method used by various OEMs in different industries is to have their replacement and clone parts tested by an independent organization, like Germany’s certification institute TÜV. This organization can confirm the better quality and durability of the original parts and the results of its investigations can be communicated to the customers in product information brochures or on posters in sales rooms. Even more efficient is to put original and replica parts on display next to each other after an endurance test, so that the difference in wear and tear on them is made obvious.

Customers generally assume that imitation parts are cheaper, without even comparing prices. But various examples from different industries show that this is often a false assumption, and that clone parts are sometimes even more expensive.

Highlighting this kind of example can be a good basis for a smart communication campaign on the part of the OEM, with clever and informative advertising, for instance in social media!

Proactive selling is an underestimated and not widespread approach in the replacement parts business. Service staff generally concentrate on processing incoming service orders and sales staff focus on selling the primary product.

Even simple measures can give an enormous boost to the sales of replacement parts. An OEM with a dealer network assessed the sales figures by article for each dealer at the end of the season, and added about 20% to each. Special sales employees then contacted the dealers, suggesting that they buy-in these larger amounts for the coming season. Most of them consented, although some did negotiate longer payment deadlines, and they were grateful to be given concrete suggestions for what to order.
On rainy Sundays, many people surf the internet looking for sunny holiday destinations. The prices rise by the minute, almost unnoticed. In the B2C market, in particular in the field of airline tickets, holiday offers, filling stations and online trading, the issue of dynamic pricing has been the topic of hot discussion for some time now. Preset prices and one price for all are anachronistic concepts. Modern, dynamic prices are constantly being adjusted using cunning algorithms, depending on the real-time supply and demand data, prices of competitors and other external factors. Big data is a key to ever more efficient algorithms and the designing of price offers tailored to individual customers.

For instance, the price can depend on the terminal device used by the user. Research done by various institutes claims that amazon.com offers iPhone or Apple users higher prices in some cases than PC users. Amazon denies this, but there are also cases in travel portals where certain hotel offers are only available to Apple users and not to their PC counterparts. Another example of dynamic prices is that online prices often depend on the individual’s surf history, with prices offered through Google links or price robots that are not necessarily the same as those on the internet trader’s website.

Outlook:

Big Data – a trend for service pricing?
A flight costs more on a tablet than on a desktop, and it is cheaper to shop in the afternoon than in the evening. Online retailer Amazon changed the prices listed on a German website 3.4 million times in April alone. The expert committee for consumer issues found out that the same package holiday was more expensive for Apple owners than for Windows users.

And many people have found that the price of the same flight can vary depending on whether you look for it on the tablet, smart phone or PC, and on how often you click on the flight. So this phenomenon is on the rise. Online prices don't change from day to day anymore, but every half hour, computer controlled, especially for laptops, smart phones, apparel and in spring for summer car tires.

The biggest danger is that customers start to feel cheated, for instance if the supermarket changes the price of an article while the customer is on the way from the shelf to the checkout. It is very difficult to regain customer confidence once something like this has happened.

On the plus side, this technique could help reduce the amount of food we throw away, for example by slashing prices shortly before the article’s expiry date. That would benefit everybody – the customer, the vendor and the environment!

This kind of dynamic pricing is not widespread in the replacement part sector, and it is difficult to imagine how it would work. Indeed, today’s practice is often based on price lists that are reworked and published annually, often still even in printed form, such as in price catalogues. This is particularly poorly suited to parts subject to major fluctuations in demand and supply.

Dynamic pricing holds risks and opportunities: it enables the optimization of sales and profits, customers can receive specially tailored price offers and product ranges and parts can be priced individually and with more range and granularity, but this requires more data that has to be collected and kept up to date. And there is also the risk of confusing or even angering customers that mustn’t be forgotten.

In B2B, the work involved in developing a logic for truly dynamic pricing that changes prices in reaction to the market would probably only pay off in a small segment of parts where competition is tough, such as for fast-moving consumer products like filters, special fluids, oils and greases, or for very high-quality components that are also offered by other suppliers.

Gathering customer data, knowing their installed basis, consumption behavior and status of their machines does open up new possibilities for OEMs, however, to run dedicated replacement parts campaigns tailored to individual customers. Data mining, sensors installed in products and the networking of products for real-time data interchange are the key technologies.
For example, if the sales of filters to an individual customer of a manufacturer of agricultural machines fall below the volume that could be expected based on machine status and machine usage data, there is probably a loyalty problem. If the customer doesn’t buy as often as it should, is it misinformed about its maintenance cycles or is it buying from a competitor that is cheaper or that proactively approaches it?

In this case a specific filter campaign that addresses these customers can be a good way of boosting sales without cutting margins. Real-time machine data also enable OEMs to offer certain repair and maintenance packages with service parts included and with prices that vary in accordance with the customer’s past behavior patterns, even before the customers make an inquiry. Another very promising option is cross- and upselling for parts that are generally used together with other parts ordered.

It is also conceivable that big data can be used in combination with, for example, weather data to recognize demand situations in the agricultural machinery field before they even arise: it is the end of the summer season, the crop is ripe and bad weather is coming.

If an important part is missing now, the tractor won’t work. Dealers could plan well in advance here, and to a much more exact level than is customary today! Vendors could be similarly proactive with anti-frost products or even with nozzles (a typical wearing part) for spraying insecticides after a mild winter.

And this could be taken even further: in the case of pests, the geographic movements and development can be tracked like a flu epidemic using Google. OEMs could assist their customers even better and proactively by offering support and launching campaigns in advance using big data.

The ideas for how to use big data in replacement part pricing are still in their infancy, and successful applications will tend to be more in the area of targeted and intelligent campaigns than in highly reactive, dynamic price adjustments as can be seen in the changes in petrol prices at filling stations.
Checklist: What does a good pricing project cover?

Phase 1:

The first phase, *Assessing the current situation*, defines the start and target point of the project and
- Includes an analysis of the existing pricing practice of the OEM, the competitive situation and a market outlook
- Is an end-to-end view of materials costs, through to the effective margin
- Identifies margin leaks along the price cascade
- Finds the most important buying arguments from the customer’s point of view
- Exposes weak points and potential for improvement

This phase ends with a further adjustment of the project scope, determines the direction of thrust for the future pricing strategy and embeds pricing in a general service strategy and other ongoing activities.

Phase 2:

The next phase, *Segmentation*, is the key to reducing complexity, thus converting the pricing of replacement parts and services into a manageable task.
- Regional markets are segmented as to their general price sensitivity, service costs and sales concept (e.g. direct versus importer markets),
- Customers and sales partners are grouped according to their willingness to pay higher prices, service expectations, market power and value for the organization as a whole,
- And the existing part segmentation is broadened to include competitive criteria and relevant value drivers such as criticality.

Phase 3:

In the *Modeling* phase a market-oriented price structure is developed.
- List prices are defined in varying price strategies such as market-based or value based,
- Regional market factors are determined to map local situations,
- Conditions for e.g. discounts and forwarding surcharges are standardized to ensure that margins are not unnecessarily foregone due to a lack of control, and
- Rules for the allocation of costs between the central and regional units are calibrated jointly.
Phase 4:

The final core phase of ‘Implementation’ puts the organization in a position to implement the new price concept.

- A central module is the defining of standard price processes, functions and responsibilities, and it also regulates the interaction between central and regional competencies. A ‘pricing calendar’ is developed, through which the pricing is embedded in the company’s general planning rhythm.
- The need for IT modifications is ascertained and the need for a dedicated pricing tools to support ongoing pricing activities is evaluated.
- The design of an implementation schedule, including milestones, the inclusion of all affected company units and proactive communication of the results and next steps closes out the pricing project.

Phase 5:

Depending on what tool is chosen, a fifth phase ‘Pricing IT tool’ can follow, which in itself has the character of a project. A requirement catalogue for functionalities is specified and depending on the make-or-buy decision, a selection process launched for an IT tool provider. Depending on the requirements, the project can be supported by a specifically tailored software solution, which can then also later be used in the ongoing price modeling to monitor the results.
Summary and conclusion

So setting prices and executing prices are the two sides of the coin when it comes to successful service pricing. A carefully executed pricing project promises a lasting increase in sales of service parts of usually up to 10% and up to 15% more earnings. But pricing is not a one-off action, it is a cyclical task with strategic and tactical components. It has to be worked on, optimized and calibrated, because a pricing concept lives and breathes!

Those who do it well will be richly rewarded, because alongside more sales and higher profits, customer loyalty, professionalism and the perception of the product range and the company on the whole also improve.

If you don’t want to leave potential unutilized in the pricing of your company’s service parts and be overtaken by your competition, it is time to do everything you can to eliminate weaknesses and reap the benefits of the strengths of a smart overall concept!

If the hotel operators on Mallorca were to all pull in one direction together with the tourism authority and the restaurant owners and the innumerable other people in the tourism industry and conceive a collaborative plan in the sense of supply chain management, they could quickly do away with the annoying drunken mobs of low-budget tourists that cause a lot of trouble without spending significant amounts of money.

But: a concept is only a concept, and needs a bigger plan behind it. Numerous small, uncoordinated actions are not a plan or a concept. With the right concept in place, the sangria chuggers on the beach of Palma de Mallorca would soon recognize the difference between cheap and inexpensive!

Cheapness can be costly!

(translation of a quote by Franz Kotteder, journalist at Süddeutsche Zeitung newspaper) who focuses on the topics of consumption and nutrition, and who is the author of the book ‘Billig kommt uns teuer zu stehen’ (Cheapness costs us dearly)
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If you were to ask businesspeople whether they would deliberately forgo sales and profits, not one of them would say yes. But that is de facto what happens if you do not have a concept-based price strategy! Many OEMs today do their pricing by the seat of their pants. Consciously differentiating between setting a price and actually executing it on the market is the first step toward an effective overall concept that leads to higher sales and better margins.

‘Set the Price’ vs. ‘Get the Price’ as an all-encompassing overall concept

Companies today still put 80% of their energy into abstract pricing, but actually pushing those prices through on the market is not given nearly the attention it deserves, although that is such a crucial part of the whole process. Many a company pays a high price for what it thinks of as saved effort early on, because once price signals are made, it is difficult to revise them.

The perfect coordination and combination of ‘Set the Price’ and ‘Get the Price’ in an overall concept, on the other hand, ensures forward-thinking companies much higher sales and profits than the customary procedures often based on rules of thumb, intuition or the extrapolation of data. But how does one proceed? What criteria have to be taken into account? Which mathematical models are used?

Read here how a coherent overall concept secures the lasting success of a business.