Managing Special Price Promotions of Service Parts B2B

An Advanced Pricing Logic White Paper

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Home of Promoter

CHALLENGE

Service parts organizations are now using powerful analytics tools to help manage their special price promotions with more precision - relying less on "gut" and more on science. Today, users have more control and power over the demand for their parts and accessories than ever before. This technology has become an accepted and essential part of merchandising tool kits at many companies.

This paper describes some of the best practices employed by service parts organizations – from pre-planning to the evaluation of the final results – including how success is measured and how systems and analytics provide essential support at key steps along the way.

SPECIAL PRICE PROMOTIONS FOR DIFFERENT PURPOSES

- REDUCE OVERSTOCKED INVENTORY

This is a case where pricing is actually used to help manage the supply chain. A foods distributor near Chicago regularly measures the promotion price elasticity for each SKU and uses it to decide how much to adjust customer discounts in order to stimulate demand the minimal amount in order to restore proper inventory balance. So when the inventory depth of an item rises and threatens to exceed prudent shelf-life limits, a special price promotion is launched automatically, applying the precise additional discount needed to restore proper balance. Just as the thermostat in your home turns on the heat when it gets cooler and turns it off when it gets warm, the supplemental discount is turned on and off (and a weekly list of specials is emailed to his customers).

Since adopting this sophisticated approach, the distributor has increased his inventory turns and reduced the amount of scrappage/waste from past levels. The technology to manage promotions and markdowns is widely used in other industries as well, for example, to facilitate the clearing of service parts inventory held in reserve for warranty demand.

- MANAGE MANUFACTURING BACKLOGS

Prices are adjusted in the opposite situation as well, i.e. supply shortages. A classic example of this is when new car dealers place "supplemental stickers" in the left rear window of "hot" models to better allocate the limited supply. Similarly, when a maker of oil field drilling equipment has a backlog at his manufacturing plants, demand is tempered by minimally adjusting customer discounts, as indicated by the price elasticity being tracked, for every product they make.

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- SEASONAL RETAIL INVENTORY BUILD-UPS

An example: the demand for tractor parts is highly seasonal so agricultural equipment dealers sell down their parts stock at the end of each season rather than carrying it over the winter. At a specified time, the equipment manufacturer would incentivize their retailers to stock up and to do so with OE parts rather than with those from competing suppliers. How much incentive is needed? A quick check with promotion price elasticity from previous seasons answers this question.

- SUPPORT NEW PRODUCT LAUNCHES

In a similar manner, an automobile manufacturer incentivizes its dealers to have a minimum supply of critical parts, which fit new models, on-hand before the need arises and thereby support their new car buyers more effectively and efficiently from day one.

- CLOSE OUTS

An automobile OEM sets a special price to close out the remaining supply of accessories that do not fit forward to the next model year. Sophisticated markdown logic is used to determine the reduction in price and the timing required to clear inventory before it becomes obsolete.

- COMPETITIVE TACTICS

One company counters the pricing actions of his competitors and halts sales volume erosion with temporary, but very effective, special price promotions and deals. He has learned not to drop everyday prices or to engage in price wars, sustaining his price integrity in the deal.

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KEY WEAPON

The not-so-secret key weapon behind these examples is a measurement called *promotion price elasticity (PPE)* or the amount of sales boost you can expect to receive for each 1 percent additional promotion discount you offer. For some parts, a 1 percent added discount will generate a big lift; for others not so big. By measuring this value for every kind of part, every time you do a promotion, you'll uncover what works and how much incentive it will take to achieve the needed boost in the future. In the process, you'll learn how to properly allocate your budgeted promotion funds to get the best financial return.

It should be pointed out that PPE is not the same thing as conventional price elasticity. The latter indicates the volume boost you can expect from *permanent* price changes. PPE, on the other hand, applies to temporary reductions lasting approximately four weeks and which have been well communicated to the market. Temporary reductions create a larger boost due to the urgency. The ability to track both metrics is available within some modern pricing solutions from third-party software firms along with the training needed for its proper use.

STEPS ALONG THE WAY

1. PLANNING THE PROMOTION

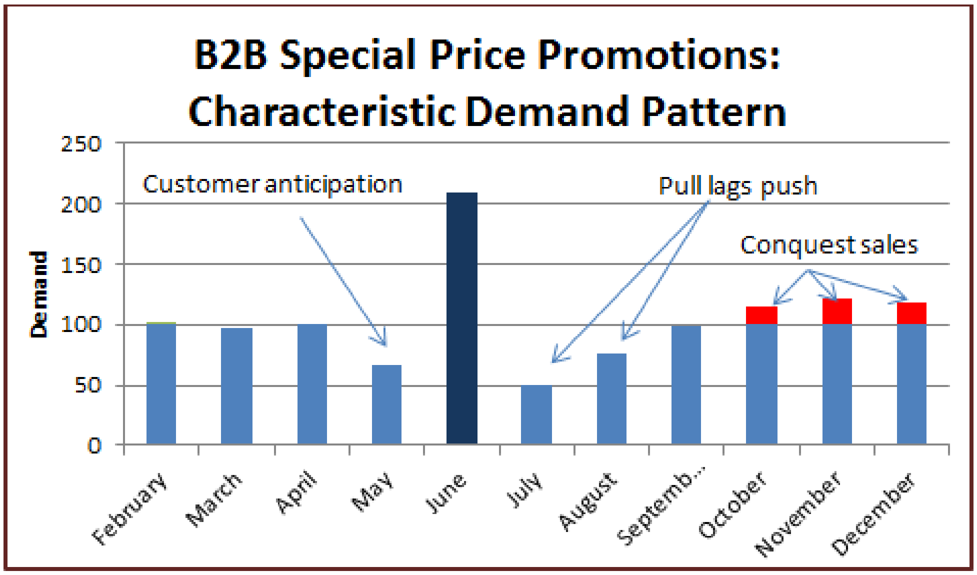
   Certain analytics tools can suggest candidates for promotion based upon a combination of factors such as rising competitive activity in certain key markets, emerging adverse sales volume trends and deepening inventory, as well as the level of success previously experienced in promoting the item. In addition to identifying candidates for promotion, a good analytics tool can estimate how much sales volume change might be expected from different discounts.

2. EXECUTION

   Release collateral materials to eligible customer segments, load special prices and timing in enterprise system, and begin fulfilling promotion orders on the launch date. Promotion sales history should be tracked separately from conventional demand. End special prices on the expiration date.

3. ASSESS RESULTS

Following every campaign, it's good practice to hold a debriefing session with your merchandising staff to review the results and decide the lessons that can be learned to apply next time (please reference the diagram below)



- CUSTOMER ANTICIPATION

When customers have advanced knowledge of a campaign, they sometimes postpone purchases to take better advantage of the lower prices. This often shows as a dip in sales volume before a launch. Advanced knowledge can be counter-productive because some of what is sold during the campaign at lower prices could have been sold at everyday prices anyway. This purchase behavior is also a characteristic of recurring campaigns. It happens for ad hoc promotions when 1.) customers are tipped off in advance by field sales representatives (especially so when they are rewarded by the promotions lift they generate) and 2.) when there's been a premature release of collateral material.

- PUSH VS. PULL LAG

The depressed wholesale sales volume seen upon conclusion of the promotion is an indication that there's front loading or temporarily unsold oversupply at the retailer/ installer level and that sufficient retail pull-through has not yet materialized. This can be a sore point with customers that, if not addressed, can diminish campaign success in the future. A good question to ask in the debriefing is how to better balance retail demand “pull” with the wholesale push?

- CONQUEST SALES

To the extent that sales volumes stabilize at a higher level than they were before the promo, there is conquest sales volume. The ratio of new to prior steady-state sales volumes is a measure of the effectiveness of the campaign.

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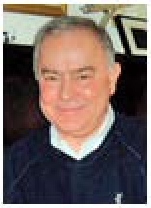
WHAT DOES IT MEAN?

The use of promotion price elasticity data empowers service parts and other organizations to manage their promotions with greater precision and to apply their budgeted funds with greater impact.

Note: This material is based upon the author's personal experience managing service parts organizations.

ABOUT THE AUTHOR:



William Huyler is President and Senior Client Advisor at Areté Strategies, a consulting firm for Fortune 100 clients on pricing strategy, process re-design and organizational transactions to modern pricing. Mr. Huyler is a long-time figure in the pricing community and has years of experience in pricing and price optimization, demand shaping, supply chain, software applications and simulation model development. He is a former VP of Price Science at Vistaar Technologies and a former Board Member of the Professional Pricing Society. He also has notable experience in the automotive industry, founding a start-up that provided pricing tools, competitive research and consulting services to a majority of the auto and truck manufacturers and importers with business in the US. He has held senior management positions at Hyundai Motor America and Volvo Cars North America.

ABOUT APL:

At Advanced Pricing Logic we are dedicated to designing innovative analytic software that makes our customers more profitable. Our software transforms data into insight and provides the platform to turn insight into action. Designed by business professionals, our software follows three guiding principles: encapsulate world class analytics, enable customers to take sound action through easy to use applications and ensure ROI less than a year after purchase.