mdm premium EXTRA

Grainger and the Pricing Dilemma

Bonus Article by Eric Smith, Associate Editor

This month we feature a bonus article on pricing dilemmas at Grainger and throughout the industry. Associate Editor Eric Smith examines recently published analysis from Baird on Grainger's "everyday low pricing" gross margin risk, recent industry statistics about pricing and other commentary about the "profit pressure" that distributors face.

If Grainger applied the "everyday low pricing" model of its e-commerce site Zoro.com to products listed on Grainger.com in the U.S., the downside risk to the company's gross margins would be about 200 basis points, according to analysis published recently by Baird.

"Most large customers already qualify for much lower prices, as do Zoro.com customers, while many small and medium customers get lesser discounts (or none at all)," according to the analysis. "With high list prices, we believe Grainger risks customer defection to other suppliers/channels over time, unless they can 'crack the code' on small and mid-sized customer pricing."

As companies look to increase sales and profitability by lowering prices, a detailed look at Grainger's pricing strategy sheds light on the dilemma many distributors face, especially as economic uncertainty raises doubt about the industry's footing in 2016 and beyond.

According to the Baird analysis, Grainger's price spectrum – the difference between the highest price and the lowest price customers would pay for the same item within the company's current pricing model – averages 27 percent.

Large customers comprised 77 percent of Grainger's 2014 sales and usually receive discounts based on volume; small customers (6 percent) "have been in decline for years" because of undiscounted items, prompting the company to develop Zoro.com; and medium-sized customers (17 percent) are the company's current focus.

"We assume more than three-quarters of Grainger's customers are already paying prices near the low end of the spectrum," the analysis reads. "While Zoro.com customers only get 'cheap and cheerful' product availability on a website, large customers qualify for volume discounts commensurate with their volume purchases, which are also wrapped in high-touch services. We assume both of these customer sets are generally satisfied with the value proposition they are receiving from Grainger.

"Non-Zoro.com small customers (still the majority today) and medium-sized customers represent

MODERN DISTRIBUTION MANAGEMENT

Founded in 1967 by J. Van Ness Philip

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ISSN 0544-6538

a secular battleground. While small customers are being addressed via Zoro.com, Grainger is refocusing on medium-sized customers – trying to better communicate value likely via pricing or levels of service. As a result of a move to an everyday low price model, this remaining approximately one-quarter of sales would be eligible for some level of discounts off their current prices."

Industry-wide issue

Across the industry, pricing continued its yearlong deceleration in the third quarter, according to the most recent MDM-Baird Distribution Survey. Distributor pricing registered -0.1 percent for the quarter – the first year-over-year decline in more than five years – as compared with a 1.1 percent increase in 3Q 2014 and a 0.5 percent increase in the second quarter.

Most U.S. regions were at or near flat for the period, with Canada's pricing improvement driven by foreign exchange factors and international markets' decline the result of weak revenue growth, according to the survey.

Pricing is a critical element in a distributor's marketing mix, but how are distributors managing their pricing? When asked in the recent State of Distributor Marketing survey (published in MDM) what strategies they use to manage product pricing, nearly 60 percent of distributors said they take the approach of comparing to a competitor's price.

Respondents to this question selected, on average, three different strategies in managing product pricing, which indicates they take a blended strategic approach rather than relying solely on one approach.

Though one-third of distributor respondents said they use a pricing tool to manage product pricing, more than half indicated the pricing tool was their ERP system and another 35 percent use no tools at all. Less than 15 percent use a tool designed specifically to assist in strategically managing product pricing, including some homegrown tools.

Sixty-six percent of distributors identified their pricing manager when asked who is responsible for setting and maintaining pricing. About half of the respondents checked two options, indicating that the responsibility was shared, while the other half of respondents had only one person with that responsibility. Slightly more than 4 percent of respondents said they have senior management involved in the process.

The prices a distributor charges must reflect the value they provide customers relative to competition, according to the State of Distributor Marketing. While two-thirds of survey respondents are looking at competitive pricing, it is unclear whether they are actually comparing the value provided to customers from competition to the value they are providing.

Customers are empowered by the choices they have when it comes to providers – no matter if it's a B2C or B2B environment – and they will only default to price in the absence of value, says Ryan Estis, who spoke at the 2015 Power Transmission Distributors Association Industry Summit. Distributors must be mindful of this as they look to promote their value proposition to existing or potential customers.

According to Brent Grover, Evergreen Consulting LLC, in the Distributor's Guide to Analytics, the right pricing strategy is critical for a distributor that wants to remain competitive, but too many companies take the wrong approach to pricing, usu¬ally focusing simply on gross margin, volume or whatever the market will bear.

"Distributors are under profit pressure as both customers and vendors try to shift more costs to the distributors," Grover writes.

"Measuring customer profitability and figuring out the root causes of profits and losses is absolutely necessary when optimizing prices. High-profit customers don't always have high margins. Their excellent results may be a combination of large order size and low cost to serve. Large-loss customers may have high margins, but their losses may be caused by small orders and high cost to serve. We can't jump to conclusions about pricing until we understand the situation with each customer."

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– *Brent Grover*, Distributor's Guide to Analytics