



e&a



PRICING OPTIMIZATION GUIDE

**An Introduction to Pricing
Optimization Concepts
and Framework**



Pricing Optimization Guide: An Introduction to Pricing Optimization Concepts and Framework

Copyright © 2025 | Published by Earnest & Associates

All rights reserved. Except as permitted under U.S. Copyright Act of 1976, no part of this publication may be reproduced, distributed, or transmitted in any form or by any means, or stored in a database or retrieval system, without the prior written permission of the publisher.

Design by Hinge. Visit our website at www.hingemarketing.com



Table of Contents

- 4 CHAPTER 1:
Introduction
- 7 CHAPTER 2:
Competing Pricing Models
- 11 CHAPTER 3:
The Pricing Optimization Structure
- 15 CHAPTER 4:
How to Develop an Execution Strategy
- 20 CHAPTER 5:
Building an Effective Mathematical Model
- 22 CHAPTER 6:
Conclusion

Introduction

Pricing optimization—the practice of identifying optimal pricing for a company’s products and services to maximize both sales and profits—began gaining popularity in the early 2000s.

The benefits experienced by early adopters spurred interest in the SMB community, where many saw the pricing optimization model as a pathway to accelerate their own success. Technology also started to evolve to better support pricing optimization as a discipline: ERP systems incorporated mechanics tailored for pricing optimization, niche applications entered the market, and consulting firms expanded their services in this field.

While the early days of the concept's growing popularity stemmed primarily from the promise of strengthening profits, there are other important outcomes that ensure this discipline continues to be a priority in leadership circles:

1 **Increased Market Share**

Through a rigorous study of competitor pricing and assessment of customer willingness to pay, pricing optimization enables companies to position themselves—and their prices—more strategically than the competition, potentially pulling market share from competitors whose pricing does not reflect that same alignment with market demand.

2 **Increased Repeat Business**

Prices can be set for different customer segments, based on how companies in those segments interact with their suppliers. Personalized pricing can help increase customers' loyalty, resulting in stronger relationships and more repeat business.

3 **Increased New Product Success**

When introducing a new product, pricing can be set to entice influential customers who are early adopters to try the new product. The momentum created will help increase new product sales.

What is Pricing Optimization?

Pricing Optimization involves analyzing customer data and market intelligence to identify an optimal price for products and services that will capture more customers and build both satisfaction and loyalty, maximize sales, and improve profits.

Pricing optimization offers a wide range of benefits by taking a more holistic approach to pricing than traditional strategies. However, it often requires a shift in how businesses view the entire pricing process. This Guide aims to help organizations and their leaders understand the concepts and framework behind this model, empowering them to make informed decisions about integrating pricing optimization into their overall business strategy.

Some of the important considerations for pursuing pricing optimization are listed below, each of which is addressed in this guide:

1. Is it possible to adopt a practical rationale to apply pricing optimization to a business? Can a systematic, best practice approach to maximize margins actually be pursued?
2. What are the critical variables to consider in making pricing decisions?
3. What role does Customer Stratification (CS) play in pricing optimization?
4. Should pricing decisions be applied the same across all localities, warehouses, customers, services, and product types?
5. How can a company leverage its existing information systems to pursue the most optimized pricing?
6. Can a system be constructed that provides insight and information to decision makers on a timely basis?

In the following sections, you'll find a mix of both theoretical and tactical points to consider as you assess your own approach for embracing and adopting pricing optimization methods into your broader business strategies.

Competing Pricing Models

Typically, pricing decisions are based on inputs such as market conditions, business dynamics, and competition factors.

However, traditional pricing approaches utilize this input in a much different way than the more modern pricing optimization discipline. Therefore, any consideration of a shift from a traditional pricing strategy to a truer pricing optimization model will represent a significant change in overall approach to growing a business.



Traditional Pricing Strategies

COST-PLUS PRICING This approach is usually preferred by C Level and Finance employees because it establishes a minimum price based on cost factors. It is a proactive pricing approach that uses real inputs, but it can result in the application of static margins across the board and missed opportunities to grow margins.

MARKET-BASED PRICING The salesforce usually prefers this approach because most sales environments focus on top line revenue goals. This approach is a reactive pricing strategy based on real inputs. However, it can result in inconsistencies in price setting and undermining company goals and opportunities to increase margins.

VALUE-BASED PRICING C Level marketing executives often prefer this approach because it recognizes the company's leadership in the market. It's a proactive approach that is based on theoretical data. In addition, value-based pricing can result in pricing that is out of touch with the market, resulting in lost sales and undermining company goals.

MATRIX-BASED PRICING This strategy uses one of the pricing methods above, but incorporates variables to provide flexibility in considering key factors such as:

- Sales/Order Mix
- Geography
- Availability/Date Required

As seen above, there are two different global structures:

- A simple structure that considers few factors, which may not align with reality, but is easy to deploy, especially in decentralized selling environments.
- A complex structure that considers many factors. It may have more alignment with reality but may be more difficult to deploy or utilize consistently. Complex structures often deploy best in centralized selling environments.

Challenges Posed by Traditional Pricing Models

Traditional pricing models often present significant challenges for companies striving to balance profitability, consistency, and strategic alignment. These models can lead to inefficiencies, misaligned incentives, and decision-making based on instinct or anecdotal information rather than data-driven insights. Below, we explore the key difficulties organizations face when navigating traditional pricing approaches and their impact on achieving business objectives.

1. There is often instinctive resistance to changing prices in a proactive and bold manner.
2. Discounting is heavily used to win business because salesforces are either focused on entirely- or heavily skewed toward-top line revenue as the singular goal. In many companies, losing sales carries heavy consequences, whereby sales people will set a price to win regardless of the associated hits to margin and other KPIs.
3. Many companies apply across-the-board price changes, even when their methods are very analytical.
4. Companies find it challenging to consistently apply uniform pricing philosophy and strategies across regions, warehouses, sales territories. They must also confront intelligently devising rational and consistent strategies that account for the unique factors in different selling environments.
5. Bid sales environments are uniquely complex. To achieve company goals, it's necessary to apply pricing rationale consistently in very diverse sales opportunities.
6. The most difficult pricing scenario is the one where the salesforce must quote in the field, on the spot. Pricing decisions in those situations are likely made ad hoc and skewed more towards spot pricing to get a sale than consistently applying strategy aligned toward company goals. It's also challenging to provide the salesforce with real-time information.
7. Pricing strategy decisions are made in silos—and therefore are disconnected to broader company goals.
8. In many organizations, what members of the sales team “think” they know about customers drives decision making around pricing. Pricing decisions are made with anecdotal information at best—guesses at worst.
9. Traditional pricing models aren't as rigorous in their reliance on KPIs, so company strategy and salesforce actions can become misaligned.
10. The salesforce may mistrust “set” pricing; therefore, they will deviate from it as they deem necessary to win the sale.

Where Pricing Optimization Fits

The greatest advantage of a true pricing optimization strategy is that it combines the strengths of traditional pricing methods into a comprehensive framework that balances top-line growth with margin generation.

Texas A&M University's Thomas and Joan Read Center for Distribution Research and Education developed a Distributor Profitability Framework, the "Seven S's", which has been adopted by many expert organizations. The Framework identifies seven business processes and shows how they relate to financial drivers. The fourth component in this framework is called Sell.

The Sell component addresses the Sales process, Marketing, and Pricing, where Pricing is the bridge that connects Sales and Marketing. It can be used as a gauge of the effectiveness of Sales and Marketing and provides a measure of their success. The Framework calls for addressing Pricing Management using the Pricing Optimization structure.

Pricing is an informational exercise and represents half of the profit equation. Bad pricing can effectively undermine satisfactory sales and marketing efforts. Pricing decisions made in a vacuum or in silos prevent a company from growing holistically. These decisions usually pit sales against margin or prevent sales and margin growth.

	Baseline	1% Price Increase	1% Decrease in COGS	1% Decrease in CTS	1% Decrease in COGS & CTS
Net Sales	20,000,000	20,200,000	20,000,000	20,000,000	20,000,000
COGS	15,000,000	15,000,000	14,850,000	15,000,000	14,850,000
Gross Margin	5,000,000 25%	5,200,000 25.74%	5,150,000 25.75%	5,000,000 25%	5,150,000 25.75%
OPEX	4,000,000	4,000,000	4,000,000	3,960,000	3,960,000
Op Margin	1,000,000 5%	1,200,000 5.94%	1,150,000 5.75%	1,040,000 5.20%	1,190,000 5.95%
Other (Inc)/Exp	(250,000)	(250,000)	(250,000)	(250,000)	(250,000)
EBITDA	1,250,000 6.25%	1,450,000 7.18%	1,400,000 7%	1,290,000 6.45%	1,440,000 7.20%

Consider the impact of a price change. Poor pricing decisions can have an exponentially negative impact on sales, margin, and EBITDA growth. In fact, changing prices outweighs all other factors in driving margin and EBITDA growth. The example above illustrates that in order to have the equivalent impact on EBITDA as that of a change in price, both COGS and CTS would have to be changed in the same proportion.

$$(X\% \Delta (\text{COGS} + \text{CTS}) \text{ Change}) = X\% \Delta (\text{Price})$$

The Pricing Optimization Structure



The pricing optimization process is multifaceted and requires a structured approach to align pricing decisions with broader company goals, as discussed in the previous section.

This structure is built on four key pillars, where each plays a critical role in ensuring pricing decisions are data-driven, strategic, and adaptable to market dynamics. The sections below detail how these pillars come together to create a robust pricing optimization framework. The pillars are as follows:

- 1 Utilizing Required Technology
- 2 Gathering Data for Analytics
- 3 Defining a Strategy
- 4 Executing the Strategy Using a Defined Process

1 Utilizing Required Technology

Pricing optimization requires managing the complexity of considering a range of relevant variables and the cross relationships among those variables. An ERP must provide a sound data structure, and it must capture relevant business transactions to enable constructing an effective system. The following ERP capabilities are required:

- Supports complex data matrix analysis
- Supports the analysis of a variable across multiple categories and levels
- Robust data mining and manipulation in support of rich analysis
- Consistency in approach, analytics, and deployment
- An enforceable decision-making hierarchy
- Mitigate opportunities to bypass or work around the pricing system
- Efficient, current, and timely delivery of critical decision-making insights
- Complex analysis that is simple and practical to implement and maintain

2 Gathering Data for Analytics

RESULTS OF ITEM STRATIFICATION that considers sales and the sales mix, categorizing item value contribution types, and product groups including item movement

RESULTS OF CUSTOMER STRATIFICATION that indicates value contribution customer types

CUSTOMER ITEM VISIBILITY that identifies the customers' sensitivity to price changes for the different products they access

PRODUCT UNIT COST that identifies the correct cost of a product or item

TRUE GROSS MARGIN that identifies the gross margin for products considering all COGS and Cost to Serve (CTS) for the product sales mix a customer generates

EXTERNAL INPUTS from the marketplace and the salesforce

3 Defining a Strategy

Pricing strategies should be defined first and foremost by careful consideration for the interconnected relationships shown on the matrix of collected data. These strategies should aim to drive growth across multiple aspects of key drivers, including:

- Increasing top-line sales
- Enhancing customer engagement
- Expanding market share,
- Improving gross margins
- Boosting Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA)

NOTE There are upwards of 576 unique scenarios that can result from the five core variables listed here. To reduce complexity, focus only on those scenarios that are most relevant to the business and represent a significant opportunity for driving growth.



4 Executing the Strategy Using a Defined Process

There are several motivations for building a true pricing optimization strategy. They include growing profitability by leveraging pricing methods and techniques, establishing a system that embodies pricing management and tools, and applying pricing best practices using scientific or mathematical methods. The defined process for executing a pricing optimization strategy should include the following:

- Building a deployment system that is practical and provides critical insight in a timely manner
- Building a deployment system that is maintained easily
- Building a deployment system that provides insightful feedback on results including trends to measure improvement
- Raising the bar for supporting IT capabilities
- Promoting pricing education, training, and understanding

The process that should be inherent in a pricing optimization strategy includes the following:

- Analyze relevant inputs
- Optimize by building a pricing plan that includes policies, goals, strategies, and tactics that are based on inputs
- Validate the plan by modeling and what-ifs
- Put emphasis on the most impactful scenarios
- Validate the data. Since the data is historical, it may fail to reflect high impact items existing in the current landscape. Therefore, access the data considering pivotal nuances and current environmental factors germane to the company such as seasonality and competitors. Include the salesforce in this step to build salesforce buy-in.
- Adapt the plan based on the result of validating the data. Define exceptions and policies to govern those exceptions.

How to Develop an Execution Strategy

When businesses plan to implement and execute a pricing optimization strategy, it is crucial to understand the set of dynamics that shape how they define their strategy. These dynamics center around four primary factors:

- 1 Pricing
- 2 Margin
- 3 Salesforce Mindset
- 4 The Customer-Competitor Environment

1 Unique Business Considerations

- How does the organization prioritize market share vs profit?
- What market information does the salesforce possess?
- What CTS information do branch managers possess?
- What is the degree of interaction between branch managers and the salesforce?
- How open is the salesforce to considering information that may challenge their perspective?
- How will competing against uninformed and unsophisticated competitors who don't price well affect the execution strategy?
- Is it effective to uniformly apply one pricing strategy to both large and small customers?
- What role does Purchasing, or should Purchasing, play in pricing strategy and decision?
- What will be the impact of a salesperson or customer on determining price?
- What role does negotiation have in pricing? What latitude should be allowed to account for negotiation in pricing strategy and decision making?
- What impact can, or should, dynamic pricing have on pricing strategy and decision making?
- Should pricing strategy and decision making consider customer ranking?
- Can a true CTS calculation be performed on any one customer? If it can, how will that calculation be defined?
- To what degree can customer and inventory stratification be cross-referenced in defining pricing strategy and decision making?

2 Margin Factors

What are commonly defined metrics?

1. Gross Margin Return on Inventory (GMROI)
2. Gross Margin Dollars (GM\$)
3. Gross Margin Percent (GM%)
4. Sales Dollars
5. Are any of the above at the order level or order line item level?

What are the factors or influences on gross margin calculations?

1. How does margin differ between product and services?
2. To what extent does the salesforce influence gross margin earned?
3. Are customers motivated only by price and availability or are there other factors to consider, and to what extent?
4. Does customer purchase frequency influence gross margin? How and to what extent?
5. Will making customers better informed influence gross margin earned?
6. Can dynamic pricing be leveraged for the following examples, and to what extent?
 - Required by date
 - Availability
 - Cost to Serve
 - Delivery Routes or Freight
 - Customer location
7. Is gross margin purely commodity-driven or can strategy, quality, and management impact it?

How prepared is an existing IT department to support a pricing optimization strategy?

Many existing IT infrastructures can't support the following requirements to perform analyses and decision making in a way that is practical and not overly burdensome:

- Datapoints and database structures and matrices to cross-relate key data into information
- Data extraction, views, and reporting interfaces
- Processing capacity to continuously update information on a timely basis
- Transaction data capture at the levels and categories required
- Ability to enforce pricing rules hierarchically in a multi-factor decision matrix



3 Salesforce Influence and Mentality Factors

- Will the salesforce promote or impede pricing optimization?
- Can the team execute and excel using pricing optimization?
- Is the team capable of, and will they provide, valuable insight and validation?

4 Customer and Competitor Factors

- How sensitive are customers to price changes?
- How much does the business know about its competitors' pricing?
- How open are customers to dynamic pricing?
- What is the role and impact of negotiations in the sales environment?

Building an Effective Mathematical Model

The objective of the mathematical model is to eliminate the subjectivity in pricing decisions that lead to inconsistent results. The capabilities of the existing IT infrastructure will enhance or limit the effectiveness of mathematical modeling. Before building an effective mathematical model, consider the following factors.

1 Exceptional Mathematical Modeling Levels

GOOD A matrix driven model based on cost-plus pricing and utilizing either list price or off-list price information

BETTER A matrix driven model based on value pricing or customer stratification/customer item visibility

BEST A matrix driven model based on customer stratification, item stratification, customer item visibility, costs, and gross margin

2 Variables to Incorporate

When considering variables, it's important to understand some of the challenges inherent in selecting variables.

- There are an overwhelming number of variables that impact pricing decisions.
- Some variables are more relevant than others in different selling environments.
- Not everyone agrees on the definition of the variables.
- Typically, not all variables can be captured or captured with accuracy within existing IT capabilities.

These challenges often lead to pricing decisions that are made based on instinct, which makes them subjective pricing decisions. Because of the complexity posed by the number of variables, it's important to focus on only the most important and keep the model as simple as possible. Otherwise, the success of adoption will be undermined.

The industry-accepted list of the most important variables to consider are:

- **CUSTOMER TYPE** Based on the results of customer stratification
- **SELLER'S ITEM RANK** Based on sales, movement, and profit
- **CUSTOMER ITEM VISIBILITY** Based on how important the item is to the Customer
- **ITEM UNIT COST**
- **GROSS MARGIN**

Conclusion

Changing a business's pricing strategy can be challenging, but there are compelling reasons to make the shift.

Traditional pricing approaches often fall short of helping companies achieve their true performance potential, as they tend to focus narrowly on winning immediate sales without considering a broader base of factors that drive continued growth and customer loyalty over the long-term. The real objective is to find a balance between driving top-line growth and enhancing profitability.

Pricing optimization offers a transformative path to sustained growth, surpassing the limitations of traditional pricing methods. Unlike traditional models that often, albeit unintentionally, view sales and profit growth as competing objectives, a well-structured pricing optimization model integrates these goals, fostering both simultaneously. Inherent in a true pricing optimization model is the flexibility to customize pricing across products and customer segments, making it a versatile and powerful tool for businesses. By drawing on some of the strengths of traditional pricing methods and inserting those methodologies into a strategy that supports both revenue and profitability, pricing optimization empowers companies to succeed in competitive markets.

To harness the full potential of pricing optimization, businesses must understand its importance and commit to the structured process described in this Guide and in doing so, companies can build a pricing strategy that is not only optimized—but is also resilient and capable of driving long-term success.



About E&A

We created Earnest & Associates with one goal in mind: to drive exceptional business profitability.

More than an implementation, software and advisory firm, we help midmarket manufacturing and distribution companies improve their operational efficiency and bottom-line results by making the most of their ERP technology. Our proprietary software turns off-the-shelf ERP products into powerful workhorses customized to address the intricacies of your business. And with over 45 years of business performance and ERP experience, nobody is better positioned to guide organizations through the challenges of building an operational competitive advantage. At Earnest & Associates, we help you see, streamline and profit from your business like never before.



To learn more about E&A, please visit our website at www.earnestassoc.com