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RIEKHOF ON PRICING No 65

Do You Have a Handle on Your Rebate Strategy?

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“It’s an observation we make time and again:
For many companies, it is not immediately transparent how high – differentiated by customers and product groups – granted rebates actually are and what portion of the company’s profits is potentially lost at what point.”

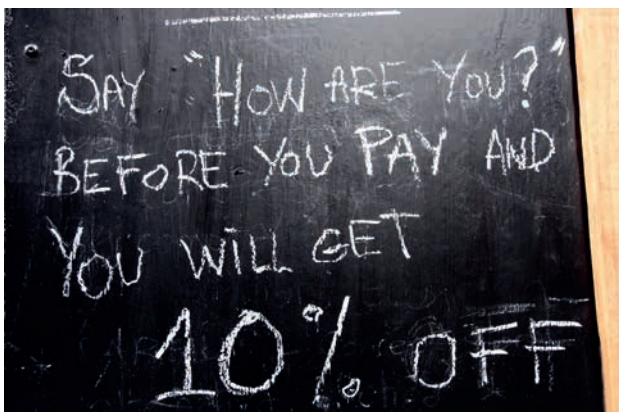
Prof. Dr. Hans-Christian Riekhof

The Four Profit Levers and a Rebate of 10%

Participants in our pricing seminar know the score: A 10% price increase is generally a much stronger profit lever compared to a 10% reduction in fixed costs, a 10% variable cost reduction or a 10% volume increase. However, this works both ways: If a company with a return on sales of 10% grants a rebate of 10% on total sales, then (ceteris paribus) for this customer the company’s entire profit margin is eroded.

Rebate Reductions are Often Easier to Implement than Price Increases

One especially interesting aspect of these observations is that rebate reductions are often considered easier to implement than a corresponding price increase. Rebate systems are also not always very transparent and comprehensible for customers, with the result that time and again we can observe that they will more readily accept a lower rebate than a corresponding price increase.



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Strict Rebate Limits as a Pricing Strategy Tool

Rebates and discounts are, of course, a strategic pricing tool that provides your sales department with more leeway and flexibility in difficult negotiating situations. However, some – by all means very successful – companies define very strict upper limits for their rebate policy. Just think of companies such as Porsche, Apple or Tesla, which would sooner risk losing sales and market share than grant a higher discount.



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Product lifecycles very often influence rebate strategies – which have always been rather limited at Porsche.

Are High Rebates or Discounts a Problem per se?

Just to be clear: In some industries, high rebates or discounts are common, and that doesn't have to be a problem in itself. In the agricultural machinery sector, discounts amounting to 50% off the OEM's list price across the various distribution tiers to the end consumer are the norm. Reducing list prices and then working, for example, with just 3 simple rebate levels would not be a good suggestion. However, what is important is to ascertain precisely whether the respective rebate components are being leveraged in a targeted and expedient manner.

Rebates and Product Life Cycles

In some industries, the product life cycle is an important benchmark for setting rebates and discounts. In the automotive sector, for example, discounts on discontinued models are correspondingly high, while very tight limits apply for new generation models. This makes sense especially where the new product generation replaces the existing generation in its entirety and products of the expiring generation still need to be sold off.

The same applies to end-of-season sales in the fashion retail sector, where surplus stock is sold off at high discounts. In some cases, up to 20% of the (total!) sales revenue must be factored in for sale discounts.

Rebate Principles – from UNICconsult's Pricing Projects

One important component of any company-wide pricing strategy is the definition of a rebate strategy. This strategy should contain statements about how rebates should (or may) be granted, the strategic and operational objectives they pursue and how they are integrated into a price controlling mechanism. Here we provide a few examples of rebate principles that we have implemented in this or a similar form in our pricing projects.

Rebate Principle No. 1: No Rebate without Reciprocity

What is meant by this is that a rebate ultimately translates to a considerable price reduction on the part of the vendor that must be honored through some form of return by the buyer. This may be higher volumes, cross-selling measures, longer contract terms and special customer loyalty, marketing cooperation or other supporting measures on the part of the customer. A pay-for-performance strategy becomes evident here.

Rebate Principle No. 2: No Rebate without Providing the Reasons for the Rebate

Few companies make it obligatory to provide a specific reason for each rebate or discount granted, which is then recorded and can be evaluated accordingly. Reasons may include new customer acquisition rebates, volume rebates, customer loyalty rebates, market launch rebates, clearance sale rebates or discounts, competitive rebates (to enable the company to compete with rival offers), cooperation rebates (where the market is developed together with the customer), dealer or distributor rebates, regional rebates (for regions with a lower market price level), rebates for specific customer groups or sectors, and many more besides.

What is important is to standardize these rebate reasons, to store them in the system and to make recording them mandatory. Like this, rebates become a very useful tool in the context of price differentiation strategies (see Pricing Newsletter No. 5 and No. 54). And they force businesses to account for rebates and keep in mind the strategic objectives behind them.



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Rebate Principle No. 3: No Rebate without Central Documentation and Time Limitation

It may sound obvious, but we have encountered the opposite often enough: Rebates and discounts always apply only for a defined period, and if they are not renegotiated or extended, they simply expire at the end of the agreed period. This presupposes that agreed rebates are centrally recorded and also evaluated. This applies particularly in the case of B2B business, of course, where regional or national companies often have a great deal of decentralized discretion when it comes to negotiating final prices.

**Rebate Principle No. 4:
No Rebate on Everything**

We all still remember the almost legendary slogan of the Praktiker DIY chain: "20% off everything – except pet food." This was certainly only intended as a marketing gag (albeit a rather catchy one).

But from the rebate strategy perspective, there is a convincing rationale: It makes a big difference whether 100% or only 70% of a large order is subject to a rebate of 15%. And good reasons can usually be found for excluding certain items in the product mix or the order from discounting.

In practice, we have, for example, excluded after sales services, spare parts (see our Pricing Newsletter No. 49), long tail products (Pricing Newsletter No. 25), products in the market launch phase or products with supply bottlenecks from the usual rebates.

**Rebate Principle No. 5:
No Hidden Rebates**

Especially in difficult negotiations, it is not uncommon for the sales department to want to or even have to make concessions that either do not fit into any scheme or that it does not wish to make transparent.

These may be additional free of charge (FOC) deliveries or additional services, for example in the field of engineering or application technology, design services in advance, consulting services, advertising cost subsi-

dies, marketing support, special service commitments, financing conditions, process validations, free sample deliveries, preferential delivery conditions, and much more besides.

Such performances ultimately also involve costs and amount to nothing other than hidden rebates (see Pricing Newsletter No. 19), which must also be made transparent in order to be able to show the actual amount of the rebate correctly.

As a result of our pricing strategy discussions, one company in the building services sector decided to stop offering project planning services free of charge. Instead, they set up a separate project planning department as a profit center and project planning work was given a price tag. Now, project planning expenditure is only credited if the customer subsequently awards a contract. In the meantime, this project planning department generates sales in the seven-digit range.

**Rebate Principle No. 6:
No Rebates without a Clear Approval Process**

This is another aspect that may sound obvious, but nevertheless needs mentioning. Depending on their position in the hierarchy, it should be defined what level of rebates sales employees, regional managers, area managers, national sales managers or managing directors are allowed to grant. A process should also be put in place to ensure that these rules and the associated escalation rules are complied with.

"In order to reduce the total discount volume we excluded in our pricing projects certain services and products from the rebates, like spare parts, longtail products, after sales services, or products in the market launch phase. It is more likely that customers accept new rebate guidelines compared to heavy price increases."

Prof. Dr. Hans-Christian Riekhof

**Rebate Principle No. 7:
No Rebates in the Context of
Short-Term Actionism**

There are very good examples of how larger companies, international corporate groups or listed companies in particular resort to short-term actionism in order to avoid potentially missing quarterly targets by issuing rebates for selected sales partners in a push to realize quick-fire additional sales and thus defend market shares. In the area of consumer electronics or electrical household appliances, a few million euros in sales can be generated very quickly by granting hefty rebates to the Media-Saturn retail group and thus realizing short-term promotional placements.

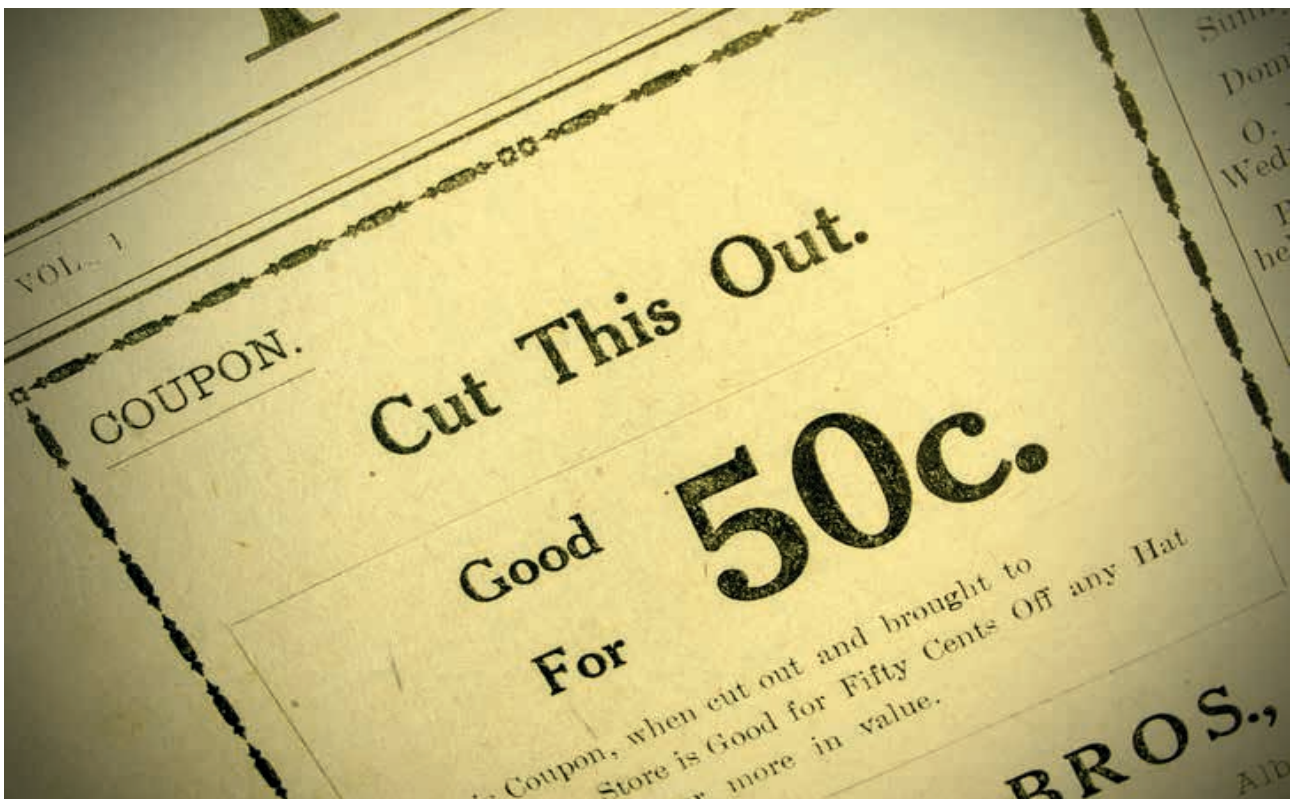
Even if this strategy proves successful in the short term, the medium-term knock-on effects can often be fatal. It undermines the rationale of the rebate strategy, the effect of the campaigns quickly wears off, in the follow-

ing quarter it becomes clear that sales have only been brought forward, and it may no longer be possible to achieve the price level in the market prior to the rebate campaigns.

**Rebate Principle No. 8:
No Rebate System without
Consistent Rebate Reporting**

In our pricing projects, we regularly ask what standardized reports and key performance indicators the financial controlling department prepares for management on the subject of rebates and discounts. All too often, this is met with looks of surprise, as these reports simply do not exist. Given the underlying earnings potential here, this is quite difficult to comprehend.

I already pointed out the need for the financial controlling department to focus more intensively on price controlling in Newsletter No. 45.



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