Take back control of Discount Rules and improve your gross margin by up to 3%

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Many businesses manage their pricing by offering individual customers a discount off a published list price. These discounts are commonly called "discount rules", "discount terms" or "discount bands". "Discount rules" is the most commonly used phrase.

Why are discount rules used to set the price offered to a customer?

There are four approaches to B2B pricing, and these range from basic to most sophisticated:

1. Price Book/Catalogue
2. Discount Rules
3. Customer Segment Discounts/Product Segment Discount
4. Customer Value Pricing

The difference between these approaches centre around the levels of granularity and execution: from a specific customer–product price to product catalogue price applied to all customers.

Each approach creates its own challenges; each has a different level of complexity and its own implementation challenges in the chosen ERP system. The table below shows the relative ratios and levels of sophistication of each pricing approach and the number of different prices in ERP. The simulation is based on 10,000 customers and 30,000 products.

Pricing Level	Customer per price	Separate Prices per product	Potential Gross Margin Value Increase
Price Book/Catalogue	10,000	1	0%
Discount Rules	1,000	30	+2%
Customer/Product Segment	100	3,000	+4%
Customer Value Pricing	1	300 million	+6%

As highlighted in the table, higher granularity and complexity offer greater potential for additional gross margin improvements. Customer value-based pricing provides the highest opportunity, as you set the price for each customer product based on what they are willing to pay. But this is for another article.

Actively managing discount rules can give you anything between a **2%-4% gross margin uplift.** However...

98% of all pricing decisions are still managed in Excel, which creates a range of problems due to the complexity of the analysis and data volume that underpins each pricing approach. Considering that an Excel spreadsheet has only has 16,384 columns, you'll not be able to see all products and customers in one single view, before even starting on a more sophisticated analysis. Put simply, using an excel spreadsheet means that Customer Value Pricing quickly becomes unmanageable.

Discount rules can offer a satisfactory option in managing pricing and controlling the business bottom line. However, without the right tools, their use can leave you blind and stretch your team's time to manually review rules and prevent the profit leakage generated by over discounting.

In the Beginning – How are Discount Rules Set?

Discount rules are generally governed through a three-level process.

LEVEL ONE: **Who** should get the discount? By deciding which customer or customer segment should be entitled to a discount from the List Price.

LEVEL TWO: **Which** products should be discounted? By identifying which product or product group should be discounted

LEVEL THREE: **What** level of discount should be allowed? By setting up a percentage discount from the list price or, if possible, a special price.

An example of the **Who?** could be either an individual customer or customer segment such as 'Large Builders', 'Medium Builders' and 'Small Builders'. However, these definitions can be varied. **Which?** covers a product group such as bricks or fasteners, but can even cover an individual product. For example, a time-limited campaign for a newly introduced product to promote it during its launch period. Lastly, **What?** Calculating discount percentages that should be ascribed to the customer segment and product group. This can be summarised as shown in the table below; the precise level of discount that is applied is based on the commercial experience of the team setting up the discount levels.

Customer Segment	Product segment			
	Bricks	Fasteners	Paint	Tools
Large Builder	15%	10%	12%	25%
Medium Builder	10%	9%	10%	20%
Small Builder	7.5%	8%	8%	17.5%
Segment 4	Xx%	Xx%	Xx%	Xx%
Segment 5	Xx%	Xx%	Xx%	Xx%

Initially, the number of discount rules is relatively low, even less than 100 and these will influence approximately 80% of the company's revenue. A central team with a pricing manager usually sets up the initial discount rules and these are loaded into the ERP. When customers visit the branch, they will be quoted a price based on the set rule for customer/customer segment and product segment; see the example below.

Customer	Segment	Product	Discount
Alan	Large Builder	Bricks	15%
Alan	Large Builder	Fasteners	10%
Jason	Small Builder	Bricks	7.5%

Over time additional rules are then created and added in response to competitor activity or customer pressure. These new rules tend to be specifically tailored to the group of products and customers to reposition the price, often in a local market:

Customer	Segment	Product	Discount 1	Area Discount
Alan	Large Builder	Bricks	15%	16%
Alan	Large Builder	Fasteners	10%	11%
Jason	Small Builder	Bricks	7.5%	Not in area

The ERP system will choose which rule to apply. Working with a different platform, we see the standard approach is to pick the rule which gives the customer the highest discount, shown in yellow on the chart. As an example of how a new rules are added, a brick manufacturer offers a promotion to you as their distributor, so another new discount rule is added. See below:

Customer	Segment	Product	Discount 1	Area Discount	Brick Special
Alan	Large Builder	Bricks	15%	16%	15%
Alan	Large Builder	Fasteners	10%	11%	15%
Jason	Small Builder	Bricks	7.5%	Not in area	15%

As new discount rules are added, the number of possible discount rules to be applied grows exponentially. We typically see >250,000 discount rules, but we have also seen a high of over 4 million in an ERP system. As a consequence, companies are losing grip over their discount structure.

Even as new rules are added and older rules are superseded, there is still a huge amount that are not actually used. Should the company worry about it if the rule is not used? It can simply be removed, right?

Unfortunately not because it is difficult to know whether rules were used for a single customer/product transaction. Plus, before you can remove the rule, you need to check if and when the rule has been used. Suppose the rule was used for any other customer or product combination; you would prefer to leave the rule rather than delete it. So, before you press delete, you need to analyse millions of other customer product combinations to be certain … it is a task which his virtually impossible to perform using Excel.

How many discount rules do I need?

If you started with several hundred rules, how do these grow to over 250,000? We have seen a regional merchant adding over 500 new rules a week, and when you cannot remove them, it is easy to understand how the number of discount rules grows quickly over time.

The question 'How many rules should I have?' has no right or wrong answer but rather one of quantum.

The number of discount rules we would expect a typical builder's merchant to require is about 5,000, but not all rules are equal in how much revenue and subsequent margin they control. Of the 5,000 rules, less than 1,000 will control 80% of the revenue and indeed, less than 300 rules will control 60% of revenue. It is no surprise that a pricing manager said when shown the 300 rules said, "That amount I can probably manage"!

When looking to remove rules, focus on the one's that make a difference! The question is: how do you know which rules these are? It can be driven by several factors; if the rule has not been used in the last 12 months, the rule is out of date, i.e., it was linked to promotion. The business can drive the classification of active vs non-active rules. But putting the business logic aside, you still need to go through millions of combinations to find the answer to that question.

Running your business where over 95% of the discount rules on your ERP are not used prevents the pricing team from having visibility and managing them. This hides lost margin opportunity, and on the top, it clogs your ERP.

How do I know if my discount rules are right?

Setting rules is based on the team's commercial experience, blending their knowledge and expertise of the client and the product. The first step is often to segment customers by business domain, i.e., builder, roofer, plumber etc. Next, apply a different classification based on the business size, i.e., large, medium, and small builders. The classification is often based on revenue and sometimes revenue plus potential.

The second component of the discount rule is the product. And the product can be defined as either a single product or a product group, sometimes including a brand. Looking at bricks, Forterra offers four types of bricks and then up to 25 individual colours/textures per type; a merchant could offer a discount rule by All Forterra products, by Brick Type or by the products that sit under a brick type.

In principle, a discount rule is assigned based on commercial experience. It is decided to offer large builders 15% off Forterra Bricks, medium builders 10%, and small builders 7.5%.

Over time, the original discount rule applied for an individual customer may not necessarily be correct today. That's because factors alter; a customer who was a large builder is now a small builder, and they may not now buy the same volume of products as when they were first classified. However, the ERP system still follows the original setting.

The impact of time and the growth of the discount rules means that as time progresses, more and more rules become sub-optimal, you will be giving away more discounts than is needed or warranted. Our research suggests that a merchant is typically operating with 50% of their rules being the right rules for the customer and product, 25% are significantly wrong, and 25% are slightly wrong; these could be costing you 3% of your already tight margin.

The quickest and best way to score your discount rules so you can understand the opportunity is to use a tool such as Bubo.ai Price Fairness Index™ .

How much are unmanaged Discount Rules Costing me?

There are two sides to this question
1. How much margin am I missing and
2. How much will it cost to get it?

The first question is the easiest, we typically see 3% of your margin is being left on the table by using incorrect rules which represents a great opportunity for a merchant, it is your money after all.

How easy is it to gain 3% extra margin? Much easier than you think; all the starting data required to optimise your discount rules is available from your ERP. All necessary tables can easily be extracted from ERP systems such as Intact, Merlin, Dynamics and Border. Mentioned ERP systems also allow for the removal of the unused rules very quickly and easily. The same with adding new rules. So no additional IT investment is necessary and the rule management follows your current business as usual

Who can help me gain 3%?

The process can be very difficult to complete in house. If Excel is your analytical tool, it'll not manage the scale and volume of data. Typically, the process needs to be run in the cloud where you have access to large computing power.

The historic way has been to use consultants every few years to review the discount rules and recommend which ones can be removed to bring clarity and efficiency. However, over time the discount rule builds up again, then repeat the process. Consultants usual quote 30-50 days of consultant time, which would equate to £30-50,000 with no guarantees in advance of the output.

There are specialist companies such Bubo.AI which offer a SaaS tool powered by AI, they offer a free evaluation of a merchant's discount rules, that will quantify how many rules are needed and how many to be removed, then score the live rules with The Price Fairness Index™ to quantify how much additional gross margin is available in advance. The charges are a low monthly fee and continue to keep a merchants rules optimised. Preventing from rules overload!

How does it work?

Bubo uses AI tools to spot unfair pricing/unfair discount rules. It works by importing all transaction data and discount rules into the platform, where they are then sorted between those that are live and those that are not. DBX then 'learns' what worked (profit improved) and what didn't (no impact on profit) and makes improvements for future transactions. Ultimately, it has the ability to optimise the profit of every customer purchase.

With Bubo.AI, we have uncovered new insights about our customers' buying behavior and changed our selling strategy accordingly. It would have taken years for us to do what the data scientists at Bubo.AI have done in a matter of days."

Robert Glasper
National Customer Service Manager

What will I get?

DBX by Bubo.AI provides merchants with the power of AI to bring order into unmanageable discount rules. This easy-to-use platform replaces spreadsheets and accounting platforms with a much simpler process that brings visibility and understanding to discount rules, and improves net profit directly.

If I sign up with them, what improvements will I see?

Getting control of your unmanageable discount rules has the potential to increase your gross margins by 3%.

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