

The rebate system as a growth opportunity for the HVAC and Sanitary segment

Creating performance-oriented and anti-trust law compliant rebate systems

Munich, April 2015

Why rebate systems are „ageing“



- Rebate systems have often historically grown – they have hardly ever been changed
- Wholesalers continuously request new, not performance-oriented and special rebates
- Manufacturers compensate this through annual price increases, “fantasy prices” develop
- High payment risk through increasingly unjustified rebate spreads across customers (e.g. when Wholesalers merge)
- Formerly common practices are coming under closer observation of anti-trust authorities
- Growing significance of e-Commerce not reflected in most rebate systems
- The full extent of a creeping margin erosion is often not known (~1-3%-pts. per year)

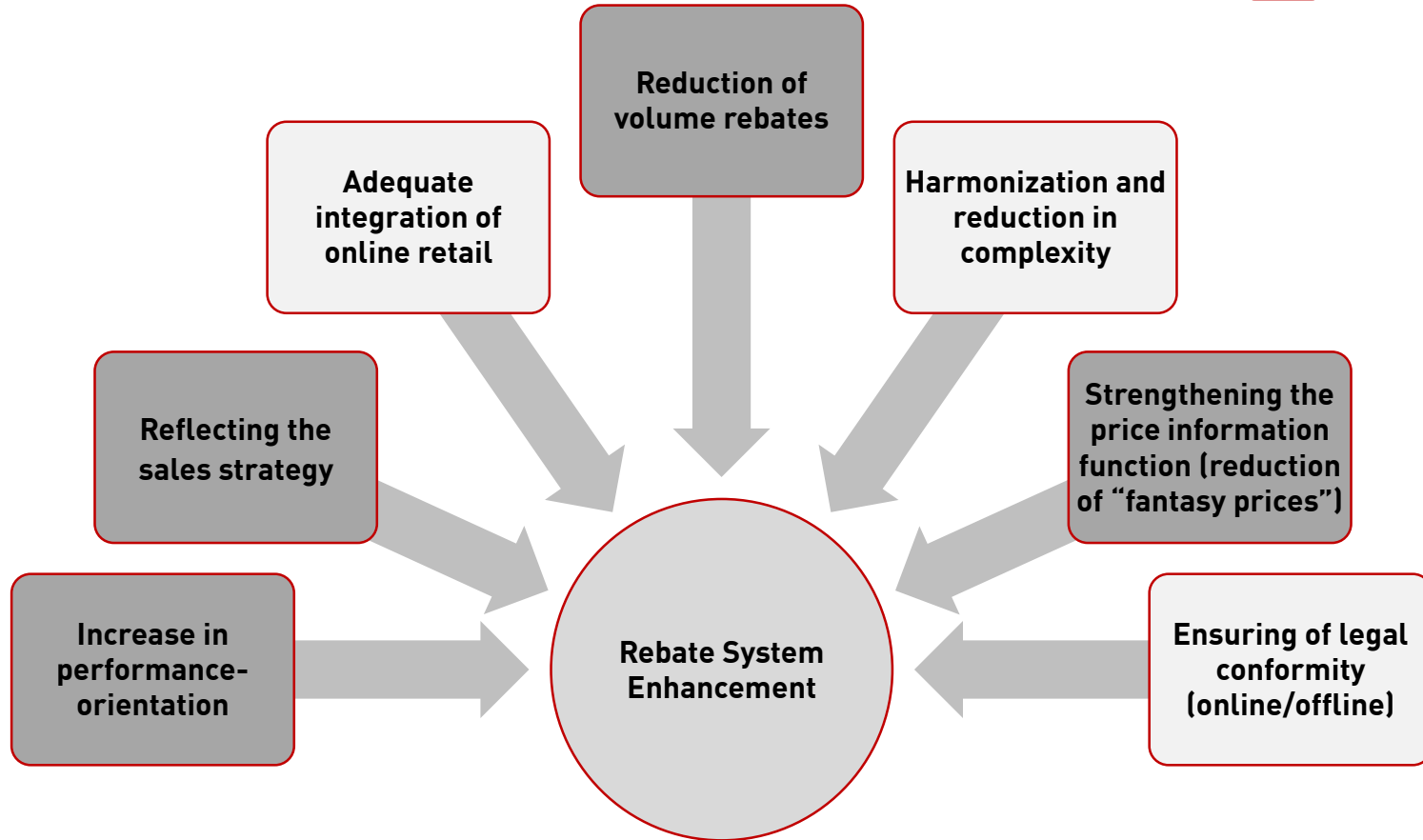
6 reasons to adjust them now

1. **Faster growth:** performance-oriented rebates lead to more active marketing by the Wholesalers
2. **Margin protection:** Marketing activities by Wholesalers have to be incentivized more
3. **Reliable price lists:** A reduction of „fantasy prices“ strengthens the information function of prices for craftsmen and consumers
4. **Protection from unrealistic demands:** The risk of retroactive best-price demands is smaller without unjustified spreads
5. **Legal security:** Anti-trust law compliant terms reduce risks for Manufacturers and Wholesalers
6. **Higher profitability:** The adjustment of payment terms often brings an opportunity for margin increases

➔ It is riskier to not adjust the system than to undertake a holistic development

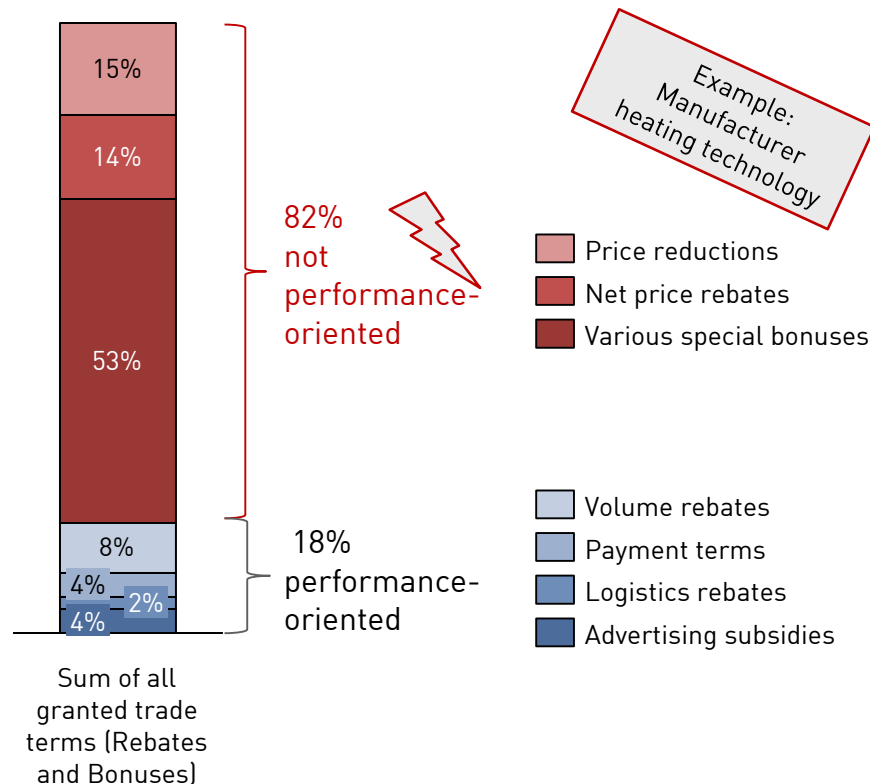
Action fields essential in “upgrading” the rebate system

 Detailed in this paper
 Not detailed in this paper



➔ The rebate system unveils huge scope for effective steering of Sales and Customers

Example: Low performance-orientation



Reasons for more performance-orientation

- **Turning costs into investments:** The share of trade terms of gross revenue is increasing for most Manufacturers. A better performance by Wholesalers creates a win-win situation
- **Creating trust:** Buyers do not need to fear being worse off than competitors, if the same, transparent system is valid for everyone
- **Protecting Wholesale-margins:** Wholesalers complain about “online-price dumping”. The top-performers will want to enforce higher prices to cover their costs. This Wholesaler “deserves” his rebates
- **Synchronization of interests:** Once the system has been implemented successfully, the potential for conflict between Manufacturers and Wholesalers reduces significantly

➔ Performance-orientation promotes growth and protects Wholesale-margins

Strategic objectives

- Availability at the POS, preventing of „cherry picking“
- Increased quality of sales consulting to enhance the pull-effect on the demand side
- Competitor displacement (Manufacturers and Private Labels)
- Improved flow of information (e.g. Wholesalers' sales data)
- Increased sales of new and premium products
- Stronger relationships with craftsmen



Embedding in the rebate system

Assortment-Bonus for physical presence of selected “fast-turning” products at all POS

Incentivization of training participation (Wholesalers), training rewards for professional craftsmen

“Revenue-Mix Bonus”, “Exclusivity Bonus”, etc.

Bonuses for customer and sales data

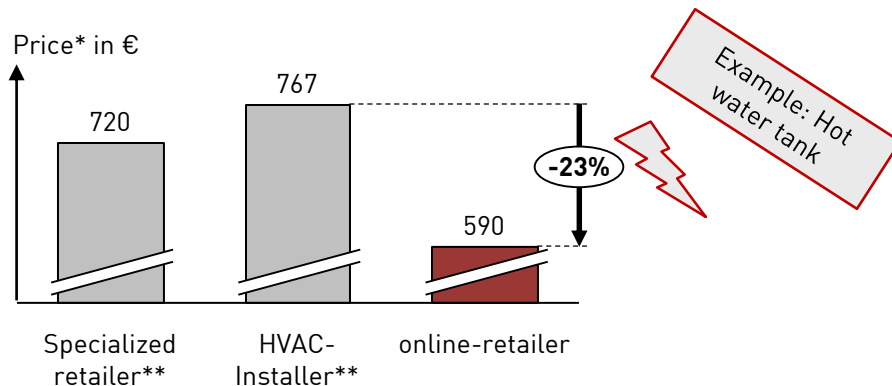
Value Bonus for increased sales of high-quality products

Direct (downstream) compensation for installed products towards craftsmen

Examples

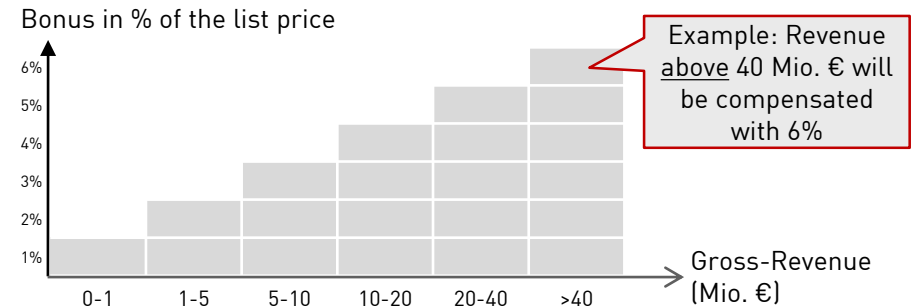
➔ The rebate system should be “tailor-made” according to market position and strategic objectives

Volume rebates promote “price dumping”



- Higher volume rebates often lead to lower Wholesaler selling prices to the next tier
- Many online-retailers are selling aggressively. Pricing transparency reduces market price levels
- Wholesalers with lower volume rebates often look to competitors or private label products. This typically leads to revenue reductions

A staggered bonus is one possible solution

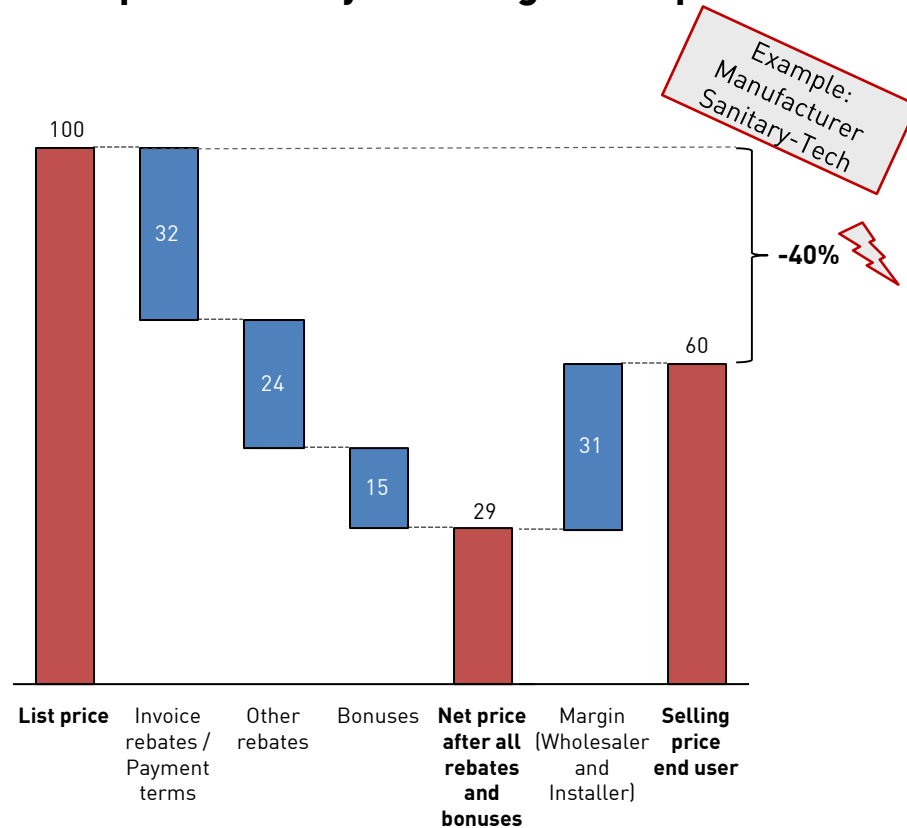


- As far as possible volume-oriented rebates should be shifted to performance-oriented bonuses, since these are not passed into the market as much
- This also reduces Wholesalers’ room for price reductions and increases their focus on full-year performance
- A staggered bonus continues to acknowledge volume performance while putting a break on price decline

➔ Protecting Wholesaler-margins is in the Manufacturer’s interest – and can be ensured via the rebate system

* Vaillant uniSTOR VIH R 120/6B, Prices as of 6th Jan. 2015 incl. VAT; ** exclusive of shipping costs, online-retailer → no shipping costs

Example: A hardly meaningful list price



Ways to correct this pricing waterfall

- Generally it should (again) hold true that: List price = Recommended Retail Price (RRP) (simplification)
- To avoid uncertainty the market price should not be more than 20% below the RRP (trust interval)
- List prices as well as corresponding rebates and bonuses should be lowered
- To ensure maximum acceptance from Wholesalers the old net purchase price level after all rebates and bonuses should be maintained, if possible
- Also applicable here: A careful shift from rebates to bonuses has a stabilizing effect on the market price

➔ Confidence-building pricing, at the same time less room for price dumping!

Conclusion: The impact of rebate systems is chronically underestimated

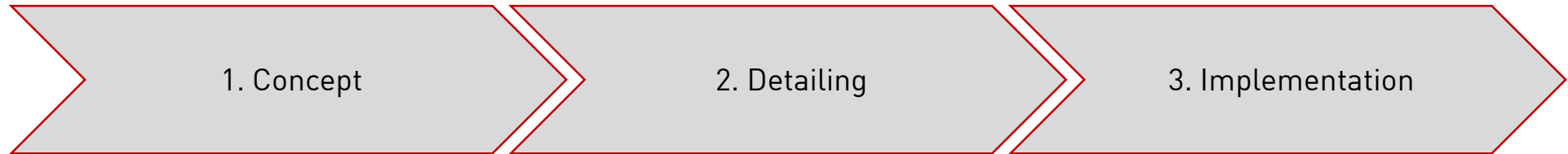
- All positive changes to the rebate system directly impact the contribution margin. Given the large share that rebates hold of the gross revenue, they are a significant lever.
- The increase in performance-orientation sets clear growth incentives for the Wholesalers. Optimized rebates systems increase margins as well as revenue.
- The individual reaction of the most important Wholesalers can and has to be anticipated. The required knowledge is usually already present within the company and should selectively be substituted with external experience.
- With a transparent and performance-oriented rebate system the buyer does no longer have to fear to be unjustifiably disadvantaged compared to his competition. This makes negotiations more fact-based again.
- During the negotiation it should be made clear that performance-oriented trade terms contribute to a margin protection for Wholesalers and that they reduce price dumping. This is a highly positive message.
- Particularly Wholesalers, who are already performing well in marketing will react positively to an increase in performance orientation.
- The Wholesalers that will be worse off at first can be pointed to the levers that can significantly increase their rebates.

➔ The rebate system is an essential lever to master the ongoing shifts in the HVAC and Sanitary industry.

Is there need for action? Decide for yourself...

- Are your Wholesalers complaining about price dumping and the connected reduction in the margins they make with your products?
- Is there a significant spread in paid-out rebates among your customers, which does not reflect individual performance levels?
- Do your rebates mainly reward size and bargaining power of your Wholesalers?
- Does your system, due to its complexity, create a lot of extra internal and external work?
- Does your system steer towards your future sales channel mix, i.e. does it set incentives for preferred channels?
- Does your system ensure a reducing dependence on Wholesalers, for example through targeted promotion of installers and end users?
- Is your rebate system set to displace competing Manufacturers and private label products?
- Are you unsure whether your system withstands the changed legal requirements?

The following approach has proven effective in enhancing the rebate system



- Checking the existing rebate system for performance-orientation and goal conformity
- Creation of concrete measures for an enhancement
- Presentation and discussion of these measures with the team
- Analysis of Do's/Don'ts also from a legal perspective
- Decision on the focus areas

- Detailed analysis of effects of different scenarios
- Evaluation of these scenarios with the team
- Adjustment/Fine-tuning of individual terms and their quantitative thresholds
- Development of a communication concept
- Implementation planning

- Development of negotiation guidelines
- Implementation coaching for sales team
- Initial talks with selected Wholesalers
- Communication of the new system to trade partners
- Signing of new contracts
- Regular impact measurement (milestones, but also quantitative target achievement)
- Ongoing implementation control



The critical focus areas of the enhancement are finalized



The quantification and the implementation plan is done



The enhanced system has been successfully implemented

... of our approach:

- Consistent alignment of the rebate system to internal and external change drivers
- Tight inclusion of selected employees during conception and simulation of the new system
- Practical enhancement of the rebate system – always keeping feasibility in mind
- Lean and goal-oriented project design so that the organization does not stand still
- Short-term amortization of the project (usually within the first year of implementation)

... of collaborating with SSC:

- Use of consultants with years of work and sector experience
- Application of know-how from other sectors, where needed
- External, neutral view from outside without “vested interest”
- Revenue-focused concept development
- High operative project management expertise
- Where necessary: Addition of legal or logistics expertise through specialized cooperation partners



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