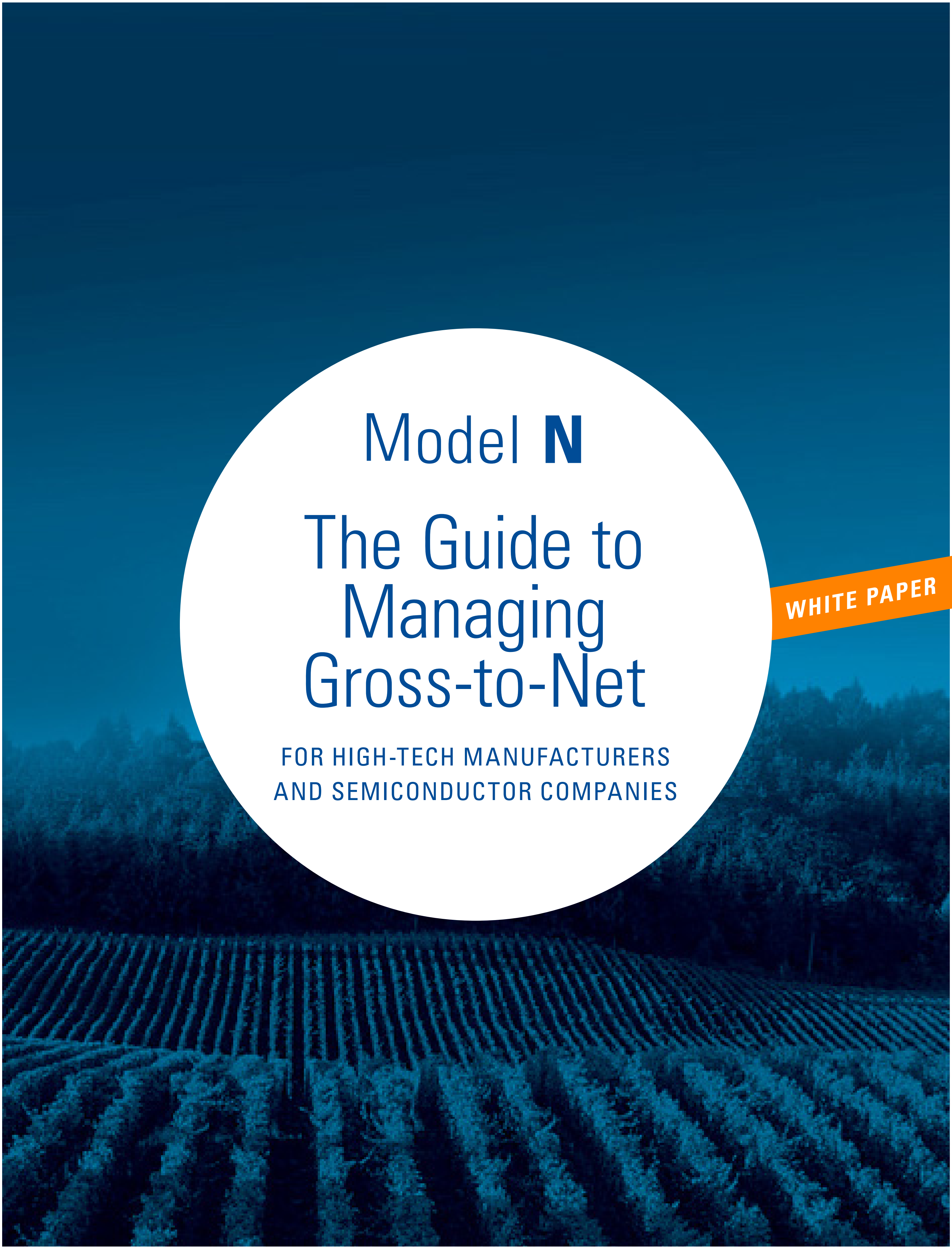


Model N

The Guide to Managing Gross-to-Net

FOR HIGH-TECH MANUFACTURERS AND SEMICONDUCTOR COMPANIES

WHITE PAPER

Managing Gross-to-Net for High-Tech Manufacturers & Semiconductor Companies

EXECUTIVE SUMMARY

Sales, Finance, and Channel executives continue to look for ways to improve how their organizations manage gross revenue through net revenue. The complexity of their product catalogs, sales channels, incentive programs, and global business makes efficiently executing on the billions of revenue execution moments accurately and quickly an arduous task. Most organizations are able to analyze what has happened in the past but are unable to actively manage their gross-to-net in real time.

In this guide, we discuss the three waves of managing gross-to-net, discuss the ideal state that organizations should aspire too, and review Model N's unique approach to today's challenges.

Introduction

To better understand the challenges of managing gross-to-net processes that high-tech manufacturers and semiconductor companies are facing today, it is essential to understand how we've gotten here.

There have been three evolutionary waves to managing gross-to-net that have been driven by market dynamics and technology:

- **Analyzing the Price Waterfall**
- **The industry move to SaaS**
- **Comprehensive management of the price waterfall**

Organizations have generally managed gross-to-net in the same way: by taking a price waterfall approach to setting, analyzing, and optimizing their pricing. This approach incorporates gathering, organizing and synthesizing price and cost-related data. Historically, the price waterfall enables organizations to achieve the best price in every transaction by identifying leakage at different price levels, i.e. list price, invoice price, net price, pocket price and pocket margin. Additionally, this approach, analyzes the following aspects of the price waterfall: contract discounts, sales discounts, and all incentives. The discounts are given for a variety of reasons, such as volume and bundling discounts. The types of incentives can vary significantly across industries and channels but in general, they are all designed to accelerate sales by providing price incentives to distribution partners, OEMs, and others. By analyzing each stage of the price waterfall, they have greater visibility into their pricing and revenue and consequently can better manage their gross-to-net revenues.

This process of managing gross-to-net turns into a continuous loop of setting, analyzing, and optimizing prices to improve margins. The result is that business leaders in sales, sales operations, and finance are always trying to monitor their gross revenue through to their net revenue via a price waterfall.

THIS PROCESS CAN PRODUCE IMPROVEMENTS

1%

improvement in pricing leads

11%

improvement in profitability

- McKinsey & Company

THE THREE WAYS OF GROSS-TO-NET

There have been three distinct waves or evolutions over the last 20 years that industries have gone through to manage gross-to-net more effectively: analyzing the price waterfall; the industry move to SaaS; and finally, comprehensive management of the price waterfall. Over these three waves, organizations have generally looked at managing pricing as the best way to control gross-to-net outcomes. The underlying premise of this approach is that price execution itself is working sufficiently. In other words, their quoting tools, back-end ERP tools, front-end tools, and CRM solutions that are at the front-end of the pricing process will optimize results. Organizations learned that if they could optimize their upfront pricing, they could optimize their revenue management and revenue execution.

In other words, organizations are focused on fine-tuning the front-end pricing process to create an improved or optimized result. This process can produce improvements for many organizations. In fact, according to McKinsey & Company, a 1% improvement in pricing leads to an 11% improvement in profitability.

This analysis by McKinsey has been proven to be true over time in multiple case studies across organizations and various industries.

The First Wave:

WATERFALL ANALYSIS

As shown to the right while certain specific industries have had success in the first wave of managing gross-to-net, this same success has eluded the high-tech sector.

This continuing inability to effectively manage gross-to-net has helped lead to the Second Wave of change.

The price waterfall analysis wave started in the late 90s as large enterprise organizations evolved their ERP, CRM, and supporting applications to focus on analyzing the stages of the waterfall. This first wave of managing gross-to-net focused almost exclusively on price optimization. Organizations used technology that focused on price waterfall analysis, price segmentation and micro-segmentation, price book management optimization, and price optimization based on predictive modeling. Utilizing these solutions to execute a price optimization strategy has led to meaningful success in several industries. For example, process manufacturing, transportation, and distribution industries to name a few, have all demonstrated quantifiable improvements in gross-to-net management through published case studies.

However, high-tech has been unsuccessful in replicating these results. There are a variety of reasons that have caused the high-tech industry to be ineffective with this approach.

- There is a higher velocity of product introductions which creates shorter product lifecycles, leading to increased pricing volatility.
- Net-new product introductions make predictive modeling impossible, for example, the introduction of the iPhone.
- The high percentage of special pricing agreements means that no matter how much they optimize on upfront pricing, these subsequent price negotiations preclude their price optimization efforts.

The Second Wave:

MOVE TO SAAS

The second wave of managing gross-to-net started in approximately 2010 when companies started retooling into new CPQ solutions after they had retooled their CRM solutions. Salesforce.com had successfully started transitioning enterprise organizations to their SaaS CRM offering. These organizations were essentially forced to retool their CPQ products because their retooling of their CRM solution had moved them to the cloud. Their legacy CPQ solutions were mostly on premise and didn't work well with their new cloud-based CRM solution.

9%

REVENUE LEAKAGE DUE TO DISCONNECTED SYSTEMS

Once the retooling was complete, organizations were initially hopeful that their pricing and gross-to-net problems would be solved. This hope came from the fact that their new CPQ solutions included pricing as a core component. What they found though was that there were very broad and deep configuration capabilities, but the pricing and quoting capabilities were rudimentary. Pricing was mainly catalog-based pricing and didn't cover all gross-to-net processes, such as incentive management.

Companies were now more proactive in trying to manage gross-to-net, but this resulted in siloed processes and technologies across the price waterfall. They dealt with a mixed bag of CRM, CPQ, point solutions, and homegrown solutions to try to manage gross-to-net. The result however, was continuing breakdowns at each stage of their price waterfall. ***This leads to as much as 9% revenue leakage due to these mostly disconnected systems.***

The Third Wave:

ACTIVE WATERFALL MANAGEMENT–THE IDEAL STATE

In approximately 2018, some of the most sophisticated high-tech organizations embarked on the third wave of managing the price waterfall. Organizations had now matured to the point where they could pursue the ideal state: Active Waterfall Management. This move represents a massive change from what they were doing previously. These third-wave organizations are going from a process where they analyze their price waterfall, to being able to manage every component of their price waterfall as a single continuum *on a single platform.*

From a functional capability perspective, organizations are bringing together all the elements necessary for effectively managing their gross-to-net. The figure below highlights these capabilities:

Figure 1.

1. Global Price Book
2. Automated Price Engines (better serve self-service, EDI and e-commerce)
3. Step Pricing

1. Discounting Controls
2. Contract Pricing and Quoting Linkage
3. Integration of Quotes, Contracts and Rebates into a single process

1. SPA / Debits
2. Discount Rebates
3. Performance Rebates
4. Claim Processing
5. Inventory and Price Protection

When analyzed across the entire price waterfall, organizations have found that they are leaking up to 9% of sales revenue due to an inability to effectively manage their price waterfall.

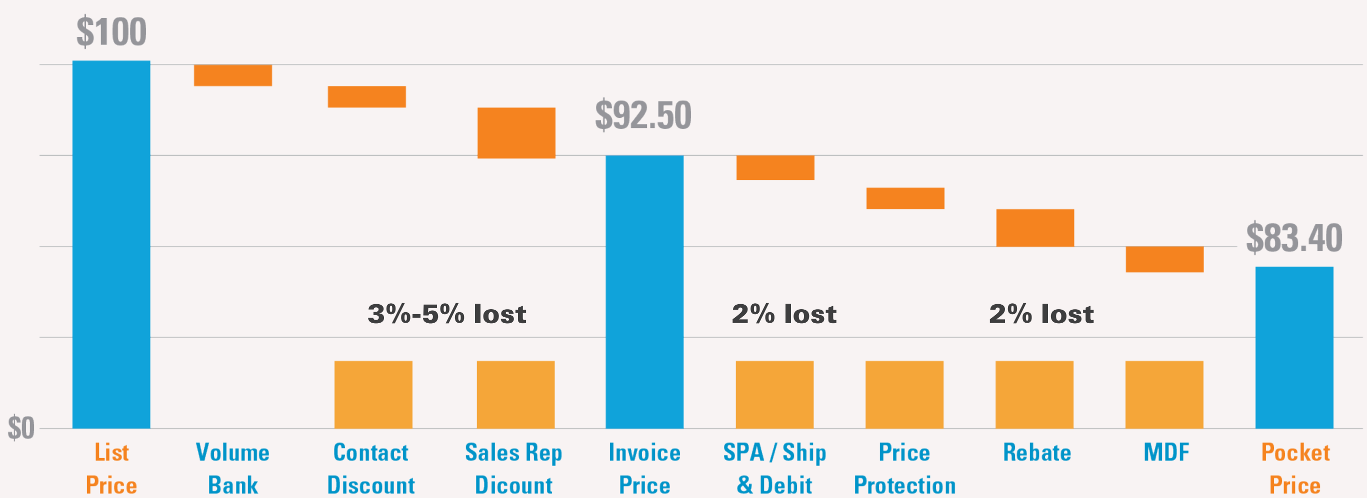
Column Graphic: 9% revenue leakage for the typical high-tech company.

Before this move, these companies had merely been analyzing their price waterfall. From that analysis, they understood that when their price waterfall processes were executed in siloed systems, a significant amount of money was being left on the table. Bringing these capabilities into one process on a single platform enables organizations to reclaim revenues that they were previously unable to. The graphic below depicts an organization's average revenue leakage at each step of the price waterfall when systems are siloed.

As the below graphic depicts, when high-tech organizations reviewed the results of their price waterfall analysis, the results were startling. ***On average, they discovered the following:***

- **3% - 5%** of revenue lost in the contracting and sales discounting phase
- **2%** of revenue lost through SPA/ship & debit, and price protection phase
- **2%** of revenue lost through rebate incentives and MDF programs

PRICE WATERFALL



50%

33% TO GREATER THAN 50% PRICE WATERFALL IMPROVEMENT

Once these companies were able to unify processes and solutions, they were able to actively manage their price waterfall in real time and reclaim formerly lost revenues. There are multiple advantages and improvements that result from this move to a common platform. One common improvement is being able to view, in real time, all other incentives that a channel or customer may be entitled to when that entity is asking for a discount.

FOR EXAMPLE:

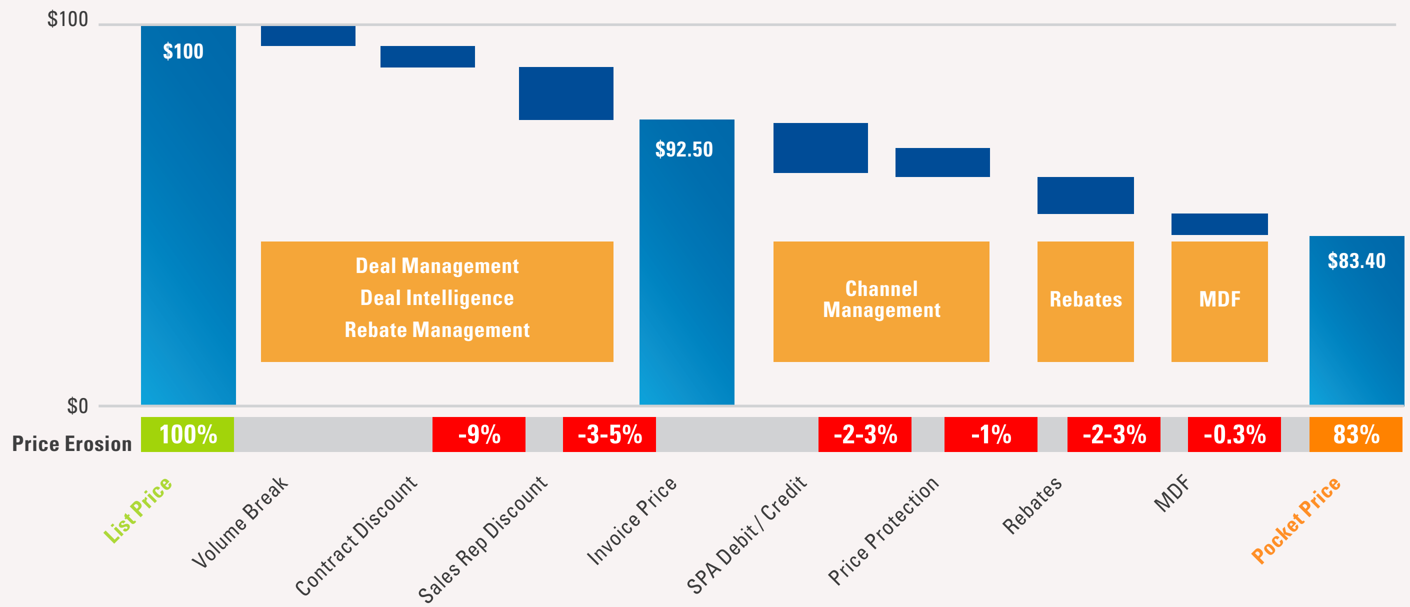
For example, a channel partner may ask for a 10% discount. While creating a new discount for the channel partner, the user can see that they are currently entitled to a 3% rebate as well. The user can then give the channel partner a 7% discount, which, combined with the 3% rebate, provides them with the desired price. Previously, the channel partner would have ended up with a 13% discount because the user didn't have access to all incentive and discounting information due to their siloed processes and systems. Another common source of revenue leakage is when organizations pay rebate claims on expired rebate programs because they cannot connect their channel sales data to rebate claims data. When channel sales data is connected to rebate programs, an organization can immediately stop overpaying expired rebates.

These third-wave organizations are now able to reclaim 3% - 5% of the revenue that they had been losing.

That represents an improvement in their price waterfall of 33% to greater than 50%. This improvement has a direct impact on total revenues, gross margins, and ultimately valuations.

One organization that was evaluating their price waterfall found that their closest competitor had a 2x greater market valuation simply because they had a 5% higher gross margin. And in fact, their competitor had successfully moved to a unified platform to manage their price waterfall two years prior.

PRICE WATERFALL



THE MODEL N APPROACH

MANAGING ALL PROCESSES FROM GROSS-TO-NET

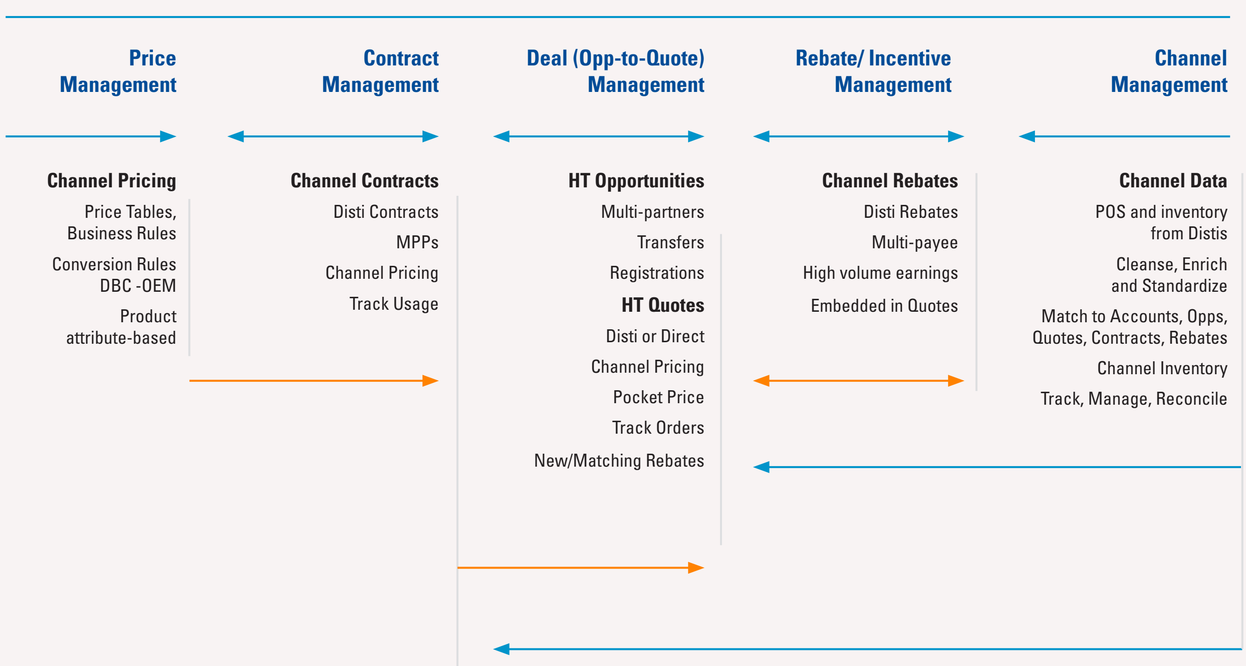
At Model N, we have a strong viewpoint about what it takes to grow the top line of your business. The strategic question we address: ***How do we maximize revenue at speed and scale across billions of revenue execution moments, every day?***

Model N delivers the commercial system of record for revenue execution between ERP and CRM. This single system of record allows organizations to manage the entire gross-to-net process in real-time proactively. The graphic above highlights the way the Model N Revenue Cloud creates a continuous functional process across a unified solution.

Model N Revenue Cloud

The Model N Revenue Cloud unifies pricing management, discounting, SPA debit/credit and price protection programs, channel incentives, and channel data to eliminate revenue leakage. No other vendor takes this unified approach to address these unique challenges. By delivering an end-to-end solution, Model N customers can eliminate error-prone human processes, remove dependencies on spreadsheets, and eliminate siloed systems. The Model N Solution allows customers to configure and quote complex products easily, quickly come to terms on complicated contracts, have more accurate and timely channel data, efficiently manage incentive programs avoiding overpayments and have visibility into inventories on demand. This end-to-end approach creates a path to success for organizations that want to go from analyzing their price waterfall to managing their revenue from gross-to-net.

END-TO-END REVENUE EXECUTION



Customer Story
ON Semiconductor

CHALLENGES

- Inconsistent global price execution
- Untraceable opportunities and lack of metrics

RESULTS

- $20M per year in increased margins
- 11% increase in quote to order conversion
- 50% reduction in quote cycle time

NEW CAPABILITIES

- Track and link opportunities and registrations to quotes
- Develop and track clear metrics and goals across pricing and sales
- Identify and focus resources on highest value-add transactions

"Model N is the heartbeat of ON Semiconductor sales operations."

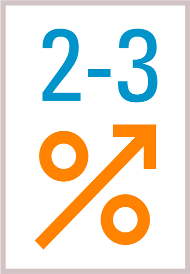
—*Randy Keadle* Corporate Pricing Manager, ON Semiconductor

Customer Story STMicroelectronics

CHALLENGES

- Inconsistent price execution and poor discounting controls
- Inability to correlate opportunities to quotes and to POS
- 19 homegrown extensions to SAP, that were not integrated to each other and a high cost to maintain

NEW CAPABILITIES



- Consistent global price execution and global discounting ***improved gross margins by 2-3%***
- Pricing rules addressing currency fluctuations ***saved $3-4M***
- Standardization onto one system ***saved IT $2.5M annually***
- Manual special pricing requests ***decreased from 55% to 38%***

"By implementing a global pricing approach with Model N we reduced our escalations from 55% to 38%, and leveraged our pricing by 2-3%."

—***Candido Duares*** VP of Sales Operations, ST Microelectronics

Thanks for your time!

To learn more about the Model N Revenue Cloud visit:

Revenue Cloud for high-tech manufacturing
visit our solution page **here.**

Revenue Cloud for semiconductor and electronic
components manufacturers visit **here.**

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