CURLY'S CONSULTING / WHITE PAPER 05

Discount leakage and margin quality

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May 2026

An evidence-based approach to finding avoidable concessions and protecting the economics of the deals you win.

Abstract

A discount is not necessarily leakage. It may buy a valuable commitment, reflect a different scope, or be necessary to win profitable business. Leakage arises when a concession gives away economics without a sufficient commercial return, or when the agreed terms fail to reach the invoice and cash collection process.

The distinction matters for private equity investors. A business can report growing bookings while the quality of its margin deteriorates through free services, rebates, credits, minimum-volume waivers, and custom terms. Conversely, simply reducing the average discount can damage contribution if it removes commercially justified flexibility.

An effective program reconstructs actual deal economics, identifies unexplained concessions among comparable opportunities, and tests policies that change behavior. Its objective is sustainable contribution from the business won, measured after the full set of commercial terms.

The decision this paper supports

Recover avoidable concessions where evidence supports a better outcome. Preserve flexibility that buys measurable value, and evaluate any tighter policy against its effect on wins, volume, servicing cost, and contribution.

1 Separate discount depth from economic quality

Consider two customers with identical list prices and nominal discounts. One prepays, buys standard scope, and requires little support. The other receives free implementation, pays late, and negotiates bespoke services. The headline discount makes them appear equivalent; the economics do not.

List prices can also distort comparison. If the list is rarely used or has changed across vintages, a smaller discount does not necessarily mean a better net price. A business can raise list price and increase discounts while leaving realized price unchanged. Measure the net economic outcome on comparable scope and quantity.

Start with a clear definition: an avoidable concession is a reduction in price or increase in cost that could plausibly be removed without an offsetting loss greater than its benefit. That is a counterfactual claim.

The gap between list and pocket price identifies where to investigate, not how much the company can recover.

McKinsey's transaction-pricing work describes the pocket-price waterfall as a way to see deductions that separate headline price from actual economics.[1] The diagnostic is useful; historical examples or average profit sensitivities should not be substituted for a company-specific recovery estimate.

2 Reconstruct the complete commercial waterfall

Join quote, approved order, contract or statement of work, invoice, credit memo, rebate, and relevant delivery cost using stable account and transaction identifiers. Preserve dates. A concession granted at signature may not affect reported revenue until later periods, and a credit issued after renewal may belong to the earlier negotiation.

Capture all negotiated dimensions, including recurring rates, setup charges, minimum commitments, included units, overage rates, free periods, and service entitlements. A single "discount percentage" field cannot represent a contract with several independently negotiated components.

Illustrative annual contract waterfall	Change	Remaining amount
List-price value for defined scope		$100,000
On-invoice discount	−$20,000	$80,000
Accrued rebate	−$4,000	$76,000
Commercial credit	−$2,000	$74,000
Avoidable product-delivery cost	−$30,000	$44,000
Incremental free support cost	−$8,000	$36,000

Synthetic example. Revenue deductions produce $74,000 net revenue. Delivery and support are then deducted to obtain contribution. Actual accounting classification should follow the company's policies and contract facts.

Keep different economic concepts visible. Free support may be a delivery cost rather than a revenue deduction. A financing or working-capital charge can help assess payment terms but should not silently be treated as an EBITDA expense. An allocated overhead charge is not necessarily avoidable if the contract disappears.

Check that each concession enters the bridge once. A rebate already reflected in net invoice revenue should not be deducted again. The list value of a waived service is not the same as its incremental delivery cost. Reconcile recognized revenue and relevant costs with finance before producing an upside estimate.

3 Find comparable opportunities before judging exceptions

Price dispersion can signal inconsistency, but customers are not interchangeable. Compare scope, volume, commitment, purchase situation, channel, geography, competitive alternatives, contract vintage, and service demands. The appropriate comparison may be among renewals for one product rather than across the entire company.

Inspect the distribution of realized price and contribution within these groups. Revenue-weighted averages show aggregate exposure; medians and quantiles reveal concentration and outliers. Separate new business from renewals and standard contracts from genuinely unusual deals.

Investigate low-price cases with the account team. Some will have a clear rationale; others will reflect inherited terms, repeated unchallenged exceptions, or inconsistent approval. Verify explanations against the contract and purchase history. "Strategic account" is a hypothesis about future value, not a complete economic justification.

Use regression or matching as diagnostics where the data permit, controlling for observable deal differences. Residual price variation is not automatically recoverable leakage. Important competitive or buyer information may remain unobserved. The analysis should prioritize questions for investigation and testing rather than convert every residual into a revenue claim.

4 Do not infer the value of discounting from win rates alone

Salespeople often discount more on difficult deals. A chart showing lower win rates at deeper discounts may reflect this selection. It does not establish that discounting causes losses. A chart showing higher win rates with discounts can also be misleading if discounts accompany changes in scope, buyer quality, or sales effort.

The relevant question is what a comparable opportunity would have done under a different policy. A randomized test of bounded discount guidance can help where commercially feasible. A phased change with a credible comparison may also be informative, provided the limitations are explicit. Preserve rejected and lost opportunities in the analysis; won-deal data alone cannot estimate the win-rate effect.

Distinguish requested, approved, and realized concessions. If the requested discount is high but approval is rarely used, the issue may be workflow rather than price. If approved terms are appropriate but invoices are wrong, policy tightening will not fix the leakage.

Estimate how policy affects both the probability of winning and contribution conditional on a win. In a simplified opportunity model with net revenue P, avoidable cost C, and win probability w:

$$\text{Expected contribution} = w(P - C).$$

More demanding price guidance can increase $P - C$ and reduce w. Both changes belong in the recommendation, along with sales-cycle and capacity effects where material.

5 Worked example: a recoverable amount is not the full gap

Illustrative assumptions. Suppose 100 annual contracts would otherwise be won or retained on the waterfall economics above: \$74,000 revenue and \$38,000 avoidable cost each. Baseline contribution is \$3.6 million. The \$26,000 difference between list and net revenue totals \$2.6 million, but much of that gap may be commercially justified.

Consider a policy expected to recover \$3,000 on 80 contracts, leave 18 unchanged through approved exceptions, and lose two additional contracts relative to baseline. Assume cost and scope remain otherwise unchanged.

$$\begin{aligned} \text{Recovered contribution} &= 80 \times \$3{,}000 = \$240{,}000, \\ \text{Contribution forgone} &= 2 \times \$36{,}000 = \$72{,}000, \\ \text{Net before program cost} &= \$168{,}000. \end{aligned}$$

With \$40,000 of annual incremental administration and systems cost, the estimated annualized EBITDA improvement is \$128,000 before one-time implementation expense.

That is a decision-worthy opportunity if supported by evidence, but it is much smaller than \$2.6 million. If five contracts were lost while 80 still accepted the improvement, the same bridge would produce only \$20,000 after the recurring program cost. Customer response is a first-order assumption, not a footnote.

New recurring terms affect earnings as the relevant contracts enter the period. A policy applied to new sales only may take considerable time to change the economics of the installed base. Model that exposure rather than claiming the full annual benefit at launch.

6 Replace arbitrary approvals with an economic exchange

An effective policy gives the salesperson a usable target, a bounded range of discretion, and a fast route for exceptions. It also defines what a concession should receive in return: committed volume, a shorter payment period, reduced scope, a standard implementation, or another verifiable benefit.

The value of the return must be measured. A large-volume promise without a minimum commitment does not have the same economics as contracted take-or-pay volume. A longer term at a low price can remove future flexibility. A customer reference may have value, but it should not justify an unlimited permanent price reduction without a specific business case.

Centralization is not automatically superior. Lal's agency model shows how the relative information held by salespeople and managers can affect the value of delegating pricing authority.[2] The practical implication is to preserve useful local information while aligning incentives and requiring an observable economic rationale. The model is not evidence that any particular approval structure will work in every business.

Set response times for the deal desk according to the sales motion. If ordinary decisions require repeated senior intervention, teams may bypass the process or grant concessions outside tracked price fields. Standard paths should be easy to use; exceptional paths should be documented and time-bound.

7 Align incentives with outcomes the team can influence

Revenue-only incentives may make additional concessions attractive to the seller even when contribution falls. Consider measures that recognize realized net revenue, contribution, or price realization, while ensuring the calculation is understandable and based on timely data. Do not reward sellers for apparent margin changes caused by arbitrary cost allocation.

Avoid introducing a metric that encourages scope distortion. A salesperson can improve apparent unit price by bundling unpaid services, shifting charges to another line, or making promises outside the order form. The incentive definition should follow the whole commercial transaction.

Review exceptions as a learning system. Repeated requests for the same concession may show that a package, list price, or contract term is poorly designed. Rejecting every request can suppress valuable evidence. Conversely, a one-time exception that becomes the standard route indicates that the policy is not controlling behavior.

Maintain reason codes with enough detail to be useful. "Competitive" should identify the relevant alternative and commercial situation. A short account-specific explanation is often more valuable than a long dropdown menu used inconsistently.

8 Assess margin quality over time

Track quoted, contracted, invoiced, and collected economics separately. Monitor net realization, contribution per comparable deal, exception frequency, waived charges, service hours, credits, win rates, sales cycle, and concentration. Use stable cohort definitions so that a richer customer mix is not mistaken for improved price discipline.

For a PE owner, sustainable improvement should survive the next renewal cycle and routine management changes. Temporary quarter-end tightening, deferred credits, or unrecognized service obligations can create a short-lived margin benefit that reverses later. Inspect the conditions under which the earnings were earned.

At diligence or exit, a stronger story is supported by reproducible waterfalls, clear policy, a history of exceptions and outcomes, and evidence that invoiced economics match the commercial intent. A lower discount percentage alone is weak evidence of a better business.

The aim is to make each concession purposeful and each economic outcome visible. That approach can recover margin while preserving the flexibility required to win valuable work, and it gives management a practical way to distinguish healthy negotiation from avoidable leakage.

9 Establish the recoverable opportunity before tightening policy

The first data requirement is a joined record of the whole commercial transaction: quote, contract, invoice, rebate, credit, scope, and relevant cost. The next is evidence about which concessions are necessary to win or retain contribution. Without both, management risks confusing a visible discount gap with recoverable earnings.

If the opportunity has not been sized, Curly's Consulting's **Pricing Upside Report** assesses current monetization practice across 23 levers and builds conditional twelve-month revenue and EBITDA scenarios with priorities and an action plan. It can establish whether discount governance deserves a deeper investment and which uncertainties dominate the financial case.

When the decision requires original buyer research, new commercial rules, and execution support, the appropriate scope is a **Pricing Transformation**. That work should connect customer alternatives and value with the deal economics and policy being tested. The objective is to identify concessions the business can remove profitably, rather than to declare every discount unnecessary.

The next commercial step

Buy the Pricing Upside Report to assess the opportunity. For a researched redesign and execution, request a Pricing Transformation quote.

Sources and methodology

This paper combines the cited published work with Curly's Consulting's analytical framework. The commercial examples, thresholds, and calculations are illustrative; they are not client results or findings from a new empirical study. Published studies support the specific claims beside their citations. Their results should not be treated as universal benchmarks for a portfolio company.

References

[1] McKinsey & Company (2003). *The power of pricing.* February 1. Practitioner analysis of transaction pricing and the pocket-price waterfall. https://www.mckinsey.com/capabilities/growth-marketing-and-sales/our-insights/the-power-of-pricing.

[2] Lal, R. (1986). Technical note—delegating pricing responsibility to the salesforce. *Marketing Science*, 5(2), 159–168. https://doi.org/10.1287/mksc.5.2.159.

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