the BUSINESS ADVISOR

KEY MANAGEMENT NEWSLETTER & UPDATES

STORM CONSULTING

Pricing: An Underutilized Tool of Top Management

Pricing is one of the most important tools available to a CEO or COO to improve operating profits and cash flow. Senior management often delegates it to the marketing or pricing department. Sometimes, senior management is involved in the initial pricing of a product, and then it is "managed" by a staff department. Yet pricing, in many situations, is often driven more by psychology than by the "market price" so often quoted by sales and senior executives. In this newsletter we will outline some of the more common B2B pricing and negotiating techniques and the psychological aspects of pricing.

SAMPLE PRICING TECHNIQUES

BAIT-N-SWITCH: In this technique, a low price is used to draw in the prospect. Then the salesperson does his best to convince the customer that s/he wants something else. Of course, the something else is invariably a higher priced item with greater margins.

UP SELLING: Another well-known technique is to sell your customer an upgraded product for a marginally higher cost. Automobile tire sales use this technique often. For example, you may see an unbelievably low price advertised for your car tires. When you try to buy the tire you are told it is "not safe" for your car but for a few dollars more you have a better tire. Once you are convinced of this tire's value the salesman tries to up sell you the next grade tire, which only cost "a few more dollars".

SPECSMANSHIP: This technique is sometimes used to respond to RFP's. Here a low price is submitted with a lower grade or less features than the customer actually needs. Once the contract is awarded on the low price then the up selling begins.

CHANGE THE PLAYING FIELD: When a competitor has a product with a lower price or a greater value, the salesman try's to change the playing filed by introducing new elements into the purchase decision. This way the salesmen attempts to neutralize a competitor's advantage.

VOLUME PURCHASES: In this situation, you offer a lower price for purchasing in quantity. Hopefully, your offering price is based upon some economies of scale you have received which you can pass along to the customer.

PRICE POINTS: Here, a price threshold is used to establish a price. For example $19.99 sounds lower than $20 although the difference is insignificant. As people have become accustomed to rounding up $0.99 to the next dollar, a price can be established at $19.87 for example, to overcome the psychological barrier of rounding up.

BENCHMARK PRODUCTS: In most business there are a handful of products, which are used by the customer to determine how the supplier "prices" his products. Once you are able to identify these benchmark products, you can then price these aggressively and make up for the lost margins on other products.

CHEVY VS. CADILLAC: In industrial sales in is normal to want to sell the customer your best model. In too many situations this tendency on the part of the sales rep. results in a lost sale even though you may have superior "price performance" with your product. The problem here is that the prospect does not value your product features and benefits the same as you. Thus you may be selling him a product, which is "overkill" for his particular needs. The competitor makes the sale because he sells the Chevy with stripped down features.

UNBUNDLING: This strategy establishes a base price for a product or service and then adds additional features and /or services to the price. In this way the customer only pays for what he needs.

STEPPED PRICING: Used in situations where there is a long-tem purchase agreement, the customer buys at a fixed price for the first order and then at a less price for subsequent orders over a fixed period of time. The customer then "steps" through the pricing.

ORDER DISCOUNTS: In this pricing model the customer earns a discount based upon how many products (in quantity and/ or type) are ordered at the same time or on the same purchase order.

DRAW PRODUCTS: A desirable or hard to find product is priced attractively to draw in the customer. One he is in a purchasing state of mind the customers buys other related or companion products. Here you make up for lost margins on the companion products.

REBATES: Rebates are another method of pricing to keep the customer "honest". Usually, the buyer and seller agree on a quantity to be purchased over a period of time. Only after the time the agreed upon quantity is achieved does the customer earns the rebate.

LOAD 'EM UP: This is a good technique for sales though a distributor or dealer channel. The idea is that you want to gain a larger percentage of the resellers sales and inventory dollars. Thus, by offering incentives to buy more of your products, your distributor will take on the inventory and be committed to sell your product.

SPIFS: When the sales force pays a significant role in the sale and can influence customers' purchasing decisions, you can provide your (reseller) sales team with additional incentives to sell a specific product. Giving the sales rep the incentive rather than to the customer, may yield higher results and maintains margins.

TECHNIQUES TO DRIVE PRICING

As previously discussed pricing is a critical element in improving cash flow and profitability. We have found that by employing proven pricing strategies coupled by top management involvement (the most important element) that we have seen margins increase dramatically. For most companies just a two-point improvement on margins will have a dramatic impact on the bottom line and on cash flow! Some of these strategies are outlined below:

PRICING COMMITTEE: Forming a ***structured*** Pricing Committee controlled by Top Management is one of the most productive pricing strategies. Top management interfaces directly with the sales organization, establishes pricing policy and participates in individual pricing exercises.

COSTING: Surprisingly, many companies do not understand their costs and often, key elements of cost are ignored or over looked. Understanding the cost drivers is critical to anticipate increases. And taking action early on in the cycle. Correct costing is essential and can greatly improve margins.

"SALES" COSTS: Many organizations drive their pricing from their cost models. By adding a small hedge in the cost model, pricing will increase faster than costs improving Gross Profit margins.

SALES COMPENSATION: Effective sales management requires informing sales professionals what you expect of them and then rewarding them for successful ***results***. In most situations, sales compensation should be driven by ***margin dollars*** not by sales or revenues!

BOTTOM 10: This is an exercise where you look at the lowest contribution products, services, customers, contracts, etc. Then you simply raise prices on the low or no margin areas to the point where you either make money or the business goes away. Either way, you win by cutting the losers or turning them into contributors! Then you work on the next 10 and repeat the process.

SERVICES: Many companies define their business in terms of "making this or that product"! But in fact, most businesses provide valuable ***services*** that they simply "give away"! By recognizing all of these services you can often identify opportunities to either charge for these services or cut out those, which the market does not value! Again, you win either way.

PRICING TRIGGERS: If you study your pricing carefully you will identify certain price "triggers" where your sales professionals, customers or competitors take certain actions. By identifying these and accompanying reactions you can make minor adjustments, which will have a significant impact on your margins. As an example we found that sales professionals discounted most on the 5 & 10% levels. By adjusting the commission plan to have a negative impact on these discount levels we were able to move the discounts to 4 & 9% levels. Thus picking up a full point of margin!

LOW & GROW: This is a strategy used in competitive bidding situations. You bid low to obtain the business to meet the ***minimum requirements.*** Then you work to provide "extra" service, features, benefits or changes, which gradually improve the margins over time.

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