

**‘SMARTER’ PRICING FOR BETTER PROFITS<sup>1</sup>**

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The current situation challenging firms’ world wide is in many senses unique, complex, and although the product of a multitude of factors, it centres on two major and interrelated phenomena both with high levels of momentum.

First: but perhaps not the most vicious, is the often cited rise of the Industrial might of mainland China.

An economy growing at an unprecedented rate and scale.

This fact impacts world pricing simultaneously on two fronts:

- It is driving-**UP** world-wide prices of, for example:
  - Energy (from Oil through Coal and Gas through, perhaps even to the construction of nuclear electricity generating plant) - and -
  - Commodities such as metals, which are critical to manufacturing: from copper and iron through to Aluminium;

Plus -

- It is driving **DOWN** the prices of manufactured goods via
  - a very low costs of labour,
  - a protected currencies - and -
  - Gross over supply.

Second: the combination and monopolisation of global power, both Political<sup>♥</sup>, Commercial and Philosophical<sup>★</sup> - again on an unprecedented scale. The result of which is instability in all three of these factors, which is leading to extreme uncertainty and volatility in most, if not in all markets.

Thus we are all experiencing unexpected tough times, just when we should be enjoying an upturn in the world’s economy. This may still happen, but one thing is sure, long periods of economic certainty and relative stability are definitely a thing of the past. Recessions will no longer be followed by a decent period of Boom during which our enterprises can consolidate. Business cycles today are some 10 to 12 years long from peak to peak<sup>▲</sup> – for our Parents and Grand Parents the period was 50 to 70 years. These current cycles are steep and unforgiving. Thus, in plain language, we will no longer have the luxury of being able to put-on enough fat during the boom to last us through the recession that follows.

Implication –

To survive and have a chance to thrive, today’s enterprises have to be at optimum profitability all of the time and that calls for all round smarter business Management.

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♥ (including military)

★ Which includes the promotion and acceptance of a particularly rapacious interpretation of Capitalism as the way to run the world’s economy.

▲ And appear to be getting even shorter.

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There are only four basic ‘Levers’ whereby a firm can improve its financial performance, these, in no order of priority, are:

- a) Optimising internal Investment,
- b) Reducing Costs,
- c) Selling more (i.e. increase volume),
- d) Optimising Price<sup>8</sup>

The last two together can dramatically out perform the first two. It is not uncommon that for a given level of improvement all round, the last two will outperform the first two by a ratio of greater than 2 to 1<sup>9</sup>. However, achieving an improvement in volumes and prices is dramatically more difficult and requires more professionalism than the same level of improvement of internal costs and/or investment. In addition more firms are of the opinion that “a Cost reduction is a fact whilst a Sales increase is an aspiration”. That is why currently much more money per capita is being spent on training procurement people than on training the sales force.

Indeed this philosophy is having a dramatic effect on business, enhancing the boldness of buyers and intimidating sellers, to the extent that some suppliers are pulling out of those industries which exhibit such predatory buyer behaviour. A good, though extreme example of which is the world-wide industry for Vaccines:-

There are only three main Buyers for Vaccines, the World Health Organisation (WHO), UNESCO and ‘The Bill Gates Foundation’ (*plus of course the host of governments throughout the developed world though most act individually*).

Not so long ago there were some seven or eight fully fledged innovative and initiating<sup>10</sup> producers of vaccines. The predatory buying behaviour of the first two bodies mentioned has, over the last decade, reduced this number to two or three (*depending on whom you count*). And still the virologists have not learned the critical lessons of ‘Market Pricing’. For example they don’t even seem to believe that the ‘Law of Supply and Demand’ applies to them. (*This law implies that the fewer the number of suppliers, then the greater will be their control over prices. In the market for novel vaccines this does not happen; sellers have been so long conditioned to be obeisant to buyers that it is a difficult habit to break*). Result, The Buyers now outnumber the Suppliers and yet still control Market Prices.

Whilst Investment decisions are usually made at CEO and Board level, cost reductions should be the responsibility of everyone in the firm (*e.g. the Japanese practice of ‘Kaizen’<sup>11</sup>*). Even so, when reducing costs, eventually either the law of ‘Diminishing Returns’, the law of ‘Unintended Consequences’ or the ‘Attrition Spiral’ or some permutation or combination of these three, will step-in and create a floor below which damage to the firm will be irreversible.

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<sup>8</sup> Note we don’t say ‘raise price’ – there is such a thing as price elasticity, which, in certain circumstances may mean that the volume increase enjoyed by a lower price may more than compensate for the loss of margin, and be more profitable than a higher price.

<sup>9</sup> The European average is said to be 4:1.

<sup>10</sup> i.e. those firms that had world class R&D departments devoted to bringing-out vaccines for clinical diseases where no vaccine had existed before, e.g. for ‘rotor virus’ (kills more children in the tropics than any other single virus) etc.

<sup>11</sup> “It is easier to make a thousand savings each of one percent, than to make one saving of one thousand percent”.

So not only is the pursuit of healthy sales volumes at healthy prices the best business philosophy (*see the second sentence of the second paragraph. on the previous page*) but, given the skills, more people in the firm can be tasked with achieving this, with a consequent improvement in the probability of success. However, to do so requires that the sales and Marketing management of the firm have an understanding of market Pricing Strategy and Practice and are competent to manage the delivery of it.

Take for example the growing popularity amongst suppliers of ‘Value Based Pricing’ strategies. The lure of this approach is that it provides salespeople with a foundation for customer negotiations that is not based on price alone. In markets as varied as computer hardware and the Financial Services Sector, senior managers see this approach as a means by which they can avoid the relentless commoditisation of their firm’s goods and services. However, the mistake many managers often make is to rely on rhetoric rather than the substance of value. The rhetoric of value focuses on describing the end goal, but too often fails to capture the essential drivers of what customers really value.

The substance of value consists of:

1. The details of the process by which the vendor’s Goods and/or Services create economic value for the customer<sup>12</sup> - plus that -
2. The sales teams have, and can use the appropriate knowledge, selling skills and tools to leverage that value when negotiating with customers.

Recent research shows that many value-based selling efforts fail.<sup>13</sup> Many reasons are blamed for these failures. However, most frequently the primary reason for this failure is that the corporate management team of the vendor company has neglected to adopt an integrated and systematic approach to value throughout all the main functions of their organisation. Ideally, such a systematic approach by the vendor should support their sales activity as itself being the final step of creating value for the customer. Previous activities should have co-ordinated the key activities, such as how the vendor’s products are rationalised to meet the range of the customer’s needs relative to the vendor’s competition, how the vendor is organised around value and whether the vendor’s managers provide their salespeople with the right skills, tools and messages to assure their success. This process should also link the vendor’s marketing and sales activities to the common goal of servicing the variety of customer’s needs in such a manner that supports the vendor’s need for increases in both volume and profits.

Unfortunately, it is never as simple as it seems. To be successful in selling value, vendors must develop their capabilities in three critical areas:

**STRATEGIC:** They should allocate resources where these can return the highest value to the vendor’s organisation: including -  
**Prioritising** high-value markets,

<sup>12</sup> See the four Levers bulleted on page one.

<sup>13</sup> McKinsey & Co., Solution Selling, Is the Pain Worth the Gain?

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**Identifying** and pursuing high-value customer segments in those markets,

**Understanding** how customer behaviours might differ even within those high-value segments.

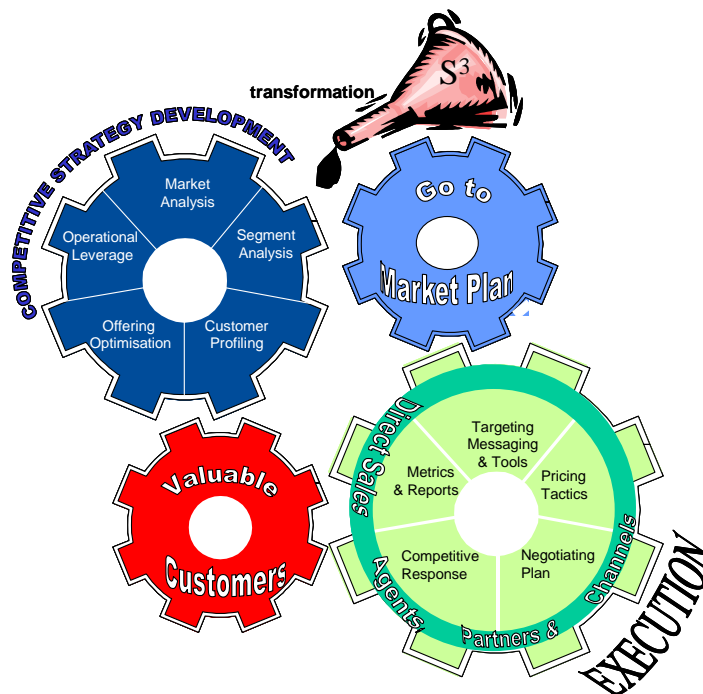
**Developing** a portfolio of ‘offerings’ that will meet the varying needs and behaviours of target customers.

**Exploiting** their own (hopefully) operational excellence for their competitive advantage.

**EXECUTION:** Ensure that sales related activities are aligned with the vendor firm’s overall strategy to achieve success.

The vendor’s management team should therefore:

- a) Provide sales teams with target customers, the appropriate value messages, and the set of tools to prove that the value offered is realistic and tangible,
- b) Set their prices to reflect the value of the offer to a given customer relative to the vendor’s competition,
- c) Implement these prices with controls and discipline,
- d) Focus and help their sales teams to develop the appropriate negotiating approaches to achieve the desired prices, whilst simultaneously building a loyal base of valuable customers,
- e) Develop an overriding plan to win business from their various competitors in local market situations,
- f) Create the appropriate metrics to evaluate results and indicate improvements to be made.



**The Value-Discipline<sup>SM</sup>**

SM =Please note this term was originated by the Strategic Pricing Group of the USA

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**ELEMENTS OF TRANSFORMATION:** Software systems will be required to smooth the transition from the old to the new process and to provide managers with quick access to the information required to make better decisions.

And finally,

**The committed support of the Vendor’s Senior Management** is required to ensure overall success.

Only when vendor firms have this type of systematic process in place can value-based programs support the salespeople with clear and credible sales tools and the appropriate offerings to assure success with customers. The ‘SPG’<sup>14</sup> labels this process “The Value Discipline<sup>SM</sup>” a major element of which is a planning process that helps salespeople better prepare their ground. It ensures that they have the right offerings and tools to survive and flourish in the negotiations for the customer’s business.

### **Cycles of Desperation**

The root causes of spiralling price-oriented customer negotiations lie in ill-conceived sales bonus payment (*i.e.* ‘*compensation*’ in US English) structures and poor sales management. If these fail to promote businesslike behaviours or provide effective value-selling tools, salespeople will quickly revert to price discounting to gain and keep customers. The problem isn’t the salespeople; it’s the poor support behind the sales teams.

For example, any salesperson with a volume-based quota or ‘bonus’ system in their payment structure AND some level of control over price, will have a natural incentive to use discounts to close the deal. Customers know and take advantage of this sales behaviour. A salesperson can close a deal at a 10% discount is going to do so every time. That salesperson still gets 90% of the compensation / bonus at the very least.

The calamity is that this behaviour means that the company will frequently loses 100% or more of the profit from such a deal. This problem exists even in bonus / compensation programs that are based partially on profit and/or gross margins.

Another cause of uncontrolled price negotiations is the use and abuse of quarterly sales targets. While the need to target sales people is obvious, the question that managers often fail to consider is: ‘*what is the cost in profits of hitting these sales numbers?*’ Managers who push salespeople to meet periodic sales targets often either push the salesperson to use price to close the deal or, in the case of large accounts, may actually take over closing itself, using low prices as the primary tactic<sup>15</sup>. These behaviours totally undermine a systematic approach to value in the firm.

Worse yet, such behaviours are self perpetuating; they send signals to both sides of the negotiation to continue down the price spiral. Customers are encouraged to hold back orders until the end of the salesperson’s bonus period and salespeople are taught that value-based sales approaches are a waste of time and do not reflect the real behaviours of their sales manager.

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<sup>14</sup> The ‘Strategic Pricing Group’ headed by Thomas T Nagler.

<sup>15</sup> In which case they have just made the sales person redundant and gained a client themselves – as though they did not already have enough to do.

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The end result is a “cycles of desperation” in which managers drive prices lower and lower to meet quarterly targets and increasingly they sacrifice operating margins to accomplish their sales goals.

The use of price to close deals should be the exception, not the rule!!

**The ‘Start line’ is Customer Value**

Customers use Goods and/or Services<sup>16</sup> to achieve something of value in their business.

**For Business to Business**, the four levers of financial Improvement (re. page two) lie at the heart of any value proposition, either singly or in some combination. The Customer is either reducing their overall costs (and our price IS a cost to them), trying to sell more volume, and/or obtain a better price from their customers.

**For Consumers**, the levers of Value lie in some permutation or combination of the five elements of “Maslow’s Hierarchy” of needs<sup>17</sup>.

By focusing on what that ‘business value’ is and how it differs from competitor to competitor, salespeople will be able to accomplish a number of important things.

**Firstly**, they will be able to understand how to respond to different competitive situations with customers.

**Secondly**, they are better able to recommend product packages that either match or beat competitive performance and/or price. This approach forces customers to make choices based on either price and/or product value.

In spite of what customers may say in the midst of a negotiation, most of them prefer value over lower prices.

**Thirdly**, the sales teams are given insights into new product features for which customers should be willing to pay more and will provide a competitive advantage for their organisation.

The Skill is attaching a Monetary Value to the customer’s use our products versus a competitor’s offering. That Monetary Value should be based on customer-specific results in the form of lower operating costs, increases in capacity, freed up working capital, more sales or higher prices et al.

Supporting documentation that is credible will make the value tangible to both the salesperson and to the customer. Such documents should help salespeople ask questions that are relevant to the customer, and elicit responses. These documents should help identify how the customer will improve their business performance as a result of adopting the right products. These tools can be complex, web-based analytical programs or simple spreadsheets formatted to accept customer inputs and provide calculations of value and return on investment on a real-time basis.

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<sup>16</sup> Please note that from here on we will use the all encompassing term ‘Products’ when discussing Goods and/or Services. Products are a bundle of benefits acquired by the customer when they make purchases. These benefits can be supplied by the ‘Good’ or by the ‘Service’ and frequently value-based products consist of both Goods and Services e.g. a motor vehicle with tw years free servicing and warrenty.

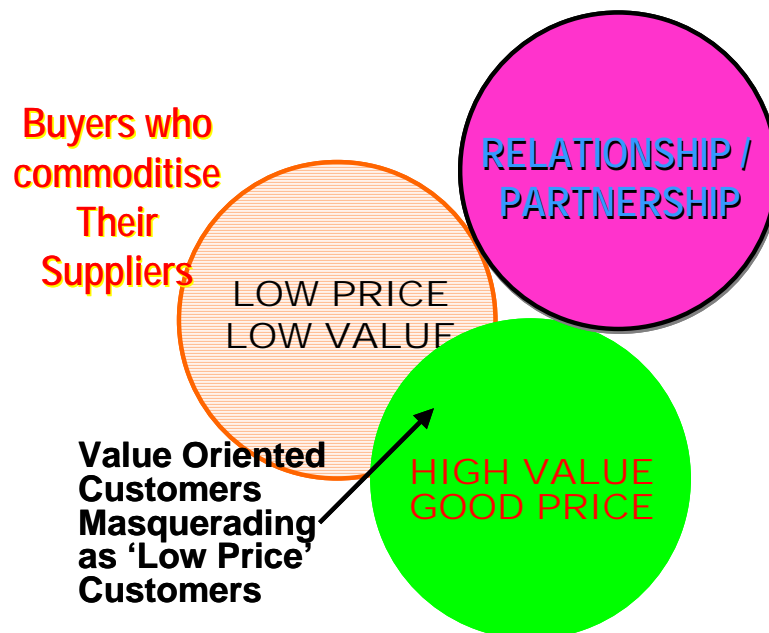
<sup>17</sup> For an excellent paper on this topic visit the website ‘ruskin-brownassociates.com’ and download the PDF of this concept you will find there.

### Not All Customer Behave the Same way

There are considerable differences in the ways that some customers, versus others, choose to approach their relationships with suppliers. A fact of life is that not all customers want to, or will be, loyal. Nor will all customers be willing to pay vendors for the value they supply. Instead, their preference, stated and actual, is often to put high-value suppliers in the same negotiating bracket as low-value suppliers with the aim that the high-value vendor surrender and provide the higher value at a lower price. This type of environment certainly requires that salespeople are able to diagnose the relevant behaviours and develop appropriate approaches for each.

Generally, customers employ one of three likely purchasing agendas when dealing with suppliers:

- 1) **‘Low Price, Low Value’ Buyers** drive to obtain products and services at the lowest possible prices. This includes qualifying many vendors to ensure that an aggressive price battle for their business ensues.
- 2) **‘High Value, Good Price’ Buyers** are willing to trade off different vendors based on the value they bring to the table and are willing to pay more for higher value offerings.
- 3) **‘Relationship / Partnership’ Buyers** rely on vendors to help them understand and apply the offering and are willing to pay higher prices for the extra values imparted by those skills and expertise.<sup>18</sup>



### Buyer Attitude Segmentation

<sup>18</sup> Nagle & Holden, *The Strategy and Tactics of Pricing*, Prentice Hall, 1998

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During the process of account planning sales people can identify likely customer behaviours, accommodate these with the appropriate offerings and employ well thought out negotiating tactics so as to minimise the damage of the No1 type of buyer, or perhaps worse, No 2 type ‘value buyers’ who have learned that they can get lower prices for higher value products by masquerading as a No.1 type, i.e. a ‘low price’ buyer. No single approach will work for all customers.

The skill is to adopt a negotiating approach that expose the buyer’s true agenda, whilst simultaneously having a proposition ready that will minimise the damage that can be done by price-oriented buyers.

However, in spite of the above, it should be perfectly acceptable to sell low price, low-value products if they fill capacity with an incremental contribution to the bottom line. The Value Discipline<sup>SM</sup> will ensure that offerings are organised in a portfolio of low-, medium-, and high-value to match the agendas of different customers, whilst simultaneously keeping the firm’s agenda for profitability in place.

**A key to the process**, is to launch the firm’s offerings with appropriate “fences” in place to prevent low-price oriented customers getting access to high-value goods and/or services.

**Sales Planning and Preparation are Critical for Successful Pricing**

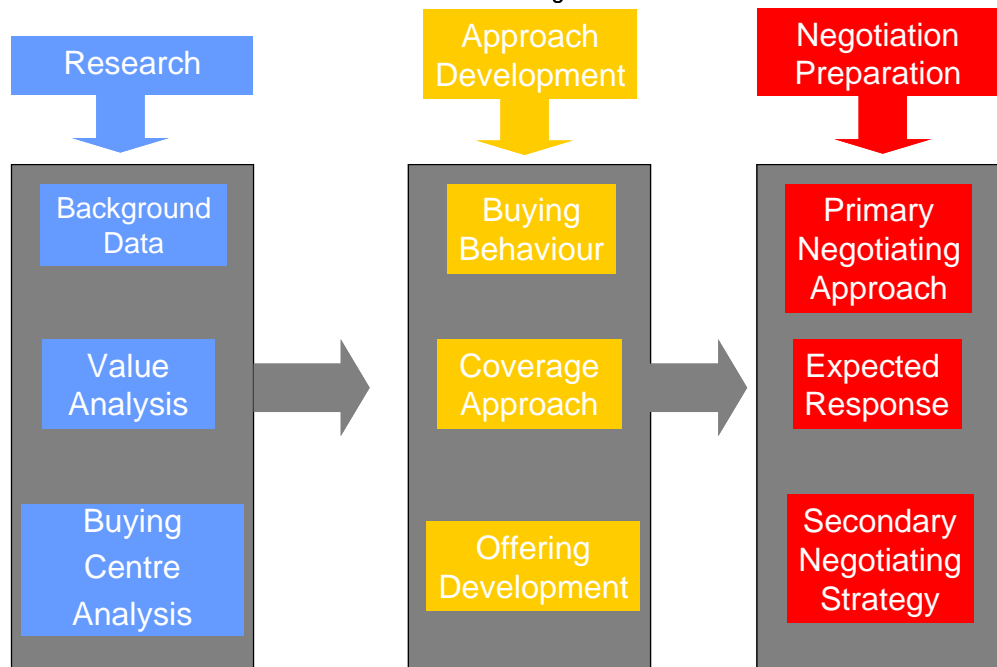
Pricing occurs in the offices of so called Procurement Departments around the world. A well-prepared sales force understands that advanced analysis and planning is essential to shift the discussion from price to value. They also know that not all customers are willing to make that shift.

**SO:** To be successful, salespeople need to prepare for all negotiations at three levels:

- 1) **Strategic:** Allocate resources to where they can return the highest value to their organisation
  - a) What is the relevant background data about the account?
  - b) How do our products create value relative to competitive offerings?
  - c) Who are the key members of the buying centre, what role do they play, and how much power do they have in the process?
- 2) **Negotiating approach:** via analysing the research, how should the sales person meet account objectives and develop plans for:-
  - a) What is the customer’s likely buying behaviour?
  - b) How should these sales people deploy key executives in the account (given their likely behaviour and buying centre analysis)?
  - c) What product choices or offerings should the sales people plan for the customer?
- 3) **Negotiation Preparation:**
  - a) How should the team position and package the proposal (Given the analysis above)? (continued . . . .)

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- b) What is the customer’s expected response to that proposal – even though it may be a guess, it provides an understanding of what offering is best and what approach may work best.
- c) Given that response, what should the backup approach be?



### The Account Planning Process

#### Conclusions

There is no question that improved sophistications in sales planning and execution leads to more revenue, profits and customer loyalty. The planning must be backed by a systematic process which links the right value offering to the right customers and does so in a way that accommodates their business needs and buying behaviours.

Effective value-based programs do as much to protect the firm’s value offerings as to sell value to the customer.

This only happens if firms have low-value “fighter-brands” with which to engage low-price competitors.

Critically, and in addition the firm’s sales team should be provided with the necessary training and tools to support their understanding of the firm’s ‘Market Position’ and offerings. They should also thoroughly understand when and how these different elements should be used. Further, sales teams should develop the sophisticated skills necessary to understand the customer’s business including how it operates, the characteristics and idiosyncrasies of the customers value chain/s, and the sources of their derived demand. They should know how their products apply to those operations and how they provide differential values versus the competition.

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**They do more than sell, they learn to ask questions in the customer’s language and to listen to their response.** Only then can they craft a specific product and sales solution to assure success at the account.

Finally, managers can support the process by developing comprehensive programs of value creation and value matching with customers. The program is driven with discipline to support salespeople sticking to their guns in complex and difficult negotiations. I don’t suggest this is easy. But I do know that the only way to gain control of the value exchange with customers is with a disciplined and proactive approach to marketing value.

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