ONE

AN OVERVIEW OF THE PRICING PROCESS

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"Even a journey of a thousand miles begins with but one step, and the best 'first step' is to get a map of where you intend to go!"

Anon

Synopsis

This chapter provides both those directions and that map.

In giving the reader a concise outline of the pricing process, it puts into perspective the sequence and order in which successful pricing is conducted by the masters of the 'discipline'.[i]

The chapter takes this process step-by-step and concludes with a 'flow diagram' to put this process into a visual perspective.

If you are an accountant, or similar by training, you could well skip this chapter, though you may well find some interesting fresh perspectives herein.

Preparing the ground

As in much of life 'attitude is everything!' It's all in the mind. If you think things can be done, chances are you will accomplish them. If however, we believe there are insurmountable obstacles in our way, as hard as we may think we try, we will never excel.

So it is important to approach pricing with a positive attitude. Whatever the size of our business – whatever our market shares, to succeed we must take the initiative. Lets look at the first initiative that should be taken.

Who takes the overall responsibility for price in our firm?

Get the command structure firmly and authoritatively established. Who is in charge of deciding the firm's policies and strategies with respect to price? Where does the buck stop? *Who has the ultimate responsibility/accountability and authority?*

The answer to this must be quite clear to all involved in setting and implementing the firm's pricing policy and practise.

Because price has a major influence on the health of the organization's income, pricing policy is critical to the survival and success of any business. So much so that, in the author's view, the overall responsibility should reside with someone close to and reporting to the CEO, if not the CEO themselves (*some people term this position the 'Pricing Tsar'*).

This 'Tsar' person should be the head of a group of advisors selected on the basis of their profit responsibility to the firm. Such people in a large organization will be found in the positions of Senior Brand Managers (*strategic and operational pricing*), Marketing Managers (*price positioning in the firm's markets*), Sales Managers (*tactical pricing and price negotiations*), the CFO or at least someone close to him or her (*the overall financial structure of the firm*).

In the smaller firm, i.e. the so-called SME[1], several of these roles could well be wrapped-up in one person. Whatever, the 'Pricing Tsar' and their team set as policy they will thus establish the guidelines within which the rest of the team will have to work.

The job of the 'Tsar' is to oversee and ensure the following process, re. pricing within the firm, and its proper execution by those in the front line:

Magnitude of Responsibility	Event Sequence	Actions/Events to optimally implement Pricing Strategies
5	1	Get top management's full commitment in advance!
4	2	Set up monitoring mechanisms
3	3	Identify and allocate resources
2	4	Assign specific, individual responsibilities – and with each –
1	5	Identify specific action steps and timeframes

Within the above team, there has to be a realistic appraisal of the role of pricing in their business. Pricing is much more than the firm being 'competitive', whatever that may mean!

Pricing also has a dynamic role to play for the firm and its goods and/or services in the marketplace. Just taking one aspect in general – for customers, price is said to be their largest single indicator of 'product' quality!

So right at the start of this book, lets bring your views on price to the forefront in our first exercise:

Exercise 1.1: The Secrets of the Right Price

Below there are eleven statements that represent some very common attitudes/views on Pricing.

This exercise was one beloved of the author's original pricing mentor, Roy Hill[ii]. Work through these statements and see whether you agree, disagree or would argue somewhere in the middle, or otherwise qualify your answer. Then turn to the appendix where you will find our views.

These eleven points typify common opinions in business with respect to price.

1. The lowest price wins the order:
2. Buyers are rational when buying:
3. Customers know what the price should be:
4. Quality determines price:
5. Match the competition price to succeed:
6. In a recession the low priced product sells best:
7. Start with a low price to win the first order – increase the price on repeats:
8. Price is a policy – costs are a fact:
9. There is a set of rules, which provides the best pricing strategy:
10. Only large companies can control prices:
11. Manufacturers control the price consumer customers pay:

WHAT DO YOU THINK??

(When you have crystallized your opinions on the above turn to Appendix 1, Exercise 1.1.)

What is the firm's cost structure and policy, re. overhead allocation?

This, and the next issue, **'the firm's marketplace'**, are inextricably linked, they are interdependent, but for clarity must be dealt with separately – at least at the start. Whatever the costing mechanism employed by the firm, such as 'mark-up', 'marginal pricing', 'activity based costing' et al. the plain fact of the matter is that overall, income must exceed expenditure or the firm will fail.

> *"Annual income £20, annual expenditure £19.98.5, result happiness,*
>
> *Annual income £20, annual expenditure £20.02.5, result misery"*
>
> **Mr. Micawber in David Copperfield**
> *With apologies to Charles Dickens for going decimal.*

As we will see later in this book the issue is certainly not straightforward. In addition to the interminable discussions within the firm as to what method should be used, almost inevitably, internal politics will have a role to play.

Classically the person dealing with pricing decisions (*lets henceforth refer to this person as the* ***'Pricer'***) will be dealing with two distinctive types of costs:

- **'Fixed costs'**, alternatively referred to as 'overheads'. In simple terms these are said not to change with alterations in price – though as we will see it's not quite as simple as that – and –
- **'Variable costs'** which vary directly with the volumes sold, often, though not always directly (*i.e. the more product you sell, the more the overall variable costs will be*).

Fixed costs/overheads

Some of these costs, with which the 'pricer' is concerned, are directly related to the product (*i.e. the goods and/or services*) being traded.

They fall into three categories:

Firstly what are known as the '**direct fixed costs**'. These are truly fixed, i.e. within limits, no matter what the volume of business they will stay the same. Examples here would be:

- The rent,
- Rates,
- Interest on capital, the wages of the workforce employed directly on the production or handling of the product.

The list goes on.

The **second** category is known as '**semi fixed costs**'. These costs will change in discrete steps in relation to changes in the business.

Examples are:

- An extra sales person (*wages, car administration et al*) to cope with increased sales,
- Warehouse space to store the extra stocks required,
- An extra shift in the factory so as to produce the extra volumes sold,
- Product advertising (*which may be purchased on a campaign-by-campaign basis*).

Again, the list goes on.

Thirdly will be **indirect costs** 'allocated' to the pricer by **head-office** so as to share out the costs of running the overall business.

The elements that build this cost may be such as:

- The maintenance and rents of the head-office building,
- The wages and salaries for the accounts department,
- The total costs of corporate research and development,
- Corporate advertising,
- The CEO's limousine,
- The costs of servicing corporate borrowing, etc.

The pricer is usually in a good position to do something about the former two types of fixed costs, and very little about the latter. Yet to the unwary it is this last category that, if unchallenged, can (*appear to*) destroy their business. For this category of costs the 'challenge' must be '***On what basis have these costs been allocated***?' and should these more properly have been taken as the head-office's responsibility so that headquarters must live within the means of the total 'contribution[iii]' made within the firm.

Unresolved, this is a festering thorn that can (*and does*) so often infect the morale of management within the firm. The larger the firm, the greater the chances that 'internal politics' will be a powerful influence on how overhead costs are attributed to the Pricer's product or division. But neither are smaller firms immune to this phenomenon.

Variable costs

These are the costs that are directly connected to the 'product', i.e. the items of the goods and/or the 'moments of truth' of the services that are being supplied to the firm's customers.

They could be things that are directly consumed by the 'production' of the good or service traded. For example, raw materials, components of the product, ink used in printing, the installation of units, and if the system is sophisticated enough, even the electricity consumed per item and/or the service giver's time, sometimes *(assuming that they are hired only when customers are served – e.g. freelance trainers*) etc.

But even these costs may not have a direct and straight-line relationship with volume.

It is not unknown for these costs to be influenced by internal politics/policies (*e.g. issues such that effect 'transfer pricing' within the business – see following*) which must be monitored with care.

Take the first issue, the relationship with 'variable costs' and volume.

A common phenomenon is that any increases in the sales volume of a good will improve the buying power of that vendor. Such that when they source the consumables/components etc. which constitute their 'variable costs', the extra volume of such purchases should translate into better buying power and thus into lower 'variable costs'. The above assumes a 'commodity market' (*see the following and Chapter 3*).

However, if there is a constraint on the supply of the required consumables and/or components that make up the 'variable costs' of the firm, this can translate into either the need for extra activity by 'procurement' so as to find alternative sources of supply and/or the need to out-bid other firms requiring these same consumables or goods – which can now translate into higher 'variable costs' for the firm.

Thus, the unit cost of a 'variable cost' can itself vary up or down depending on the volumes traded and the types of markets from which these consumables or components are sourced.

It does not end there!

For large global firms that source much of what they need from within their own firm, there is the spectre of 'transfer pricing' to be addressed.

This is not the platform on which to examine this activity in depth, however, suffice to say that the pricer, in a large global firm who encounters this phenomenon, must indeed keep their wits about them. Internal politics via aggressive 'transfer pricing' can play an adverse role in the apparent profitability, or lack of it, for departments within the firm.

We discuss the profit and loss accounts/calculations (so called P&L) in Chapter 2. For now it is sufficient to stress that the management of the firm's various P&L's will depend critically on the pricer having the above situation, re fixed and variable costs, constantly under surveillance and at their fingertips.

The firm's marketplace

Whoever is making the pricing decision in the firm, they must also be well informed about what is going-on in their marketplace.

The 'ten-point must-know list'

Such background information must encompass answers to questions such as:

1. 'How large is the market?'
2. How competitive is it?
3. What is the current 'market price'?
4. What is the firm's market position/market share?
5. Where are our products on the curves of:
    a. 'Supply and demand',
    b. Product 'life cycle' and perhaps the –
    c. 'Technology adoption curve'?
6. What are the price elasticity's of our products in these markets?
7. What are the types and extent of the elasticity's of price for our product/s?
8. Is the market structured or unstructured?[iv]

9. Is this a market in which our product/s are already established or is it a market we will have to enter anew? – and if so:

10. What will be our penetration strategy?

The list can extend further – but you get the drift of where this is going – **The more you know, the greater the chances that the pricing decisions will succeed.**

Before moving on, a few words about some of the items in the above list.

Most strategies fail because there is not the necessary level of 'tactical ability' to deliver them in the field (see Chapter 6). Therefore a major concern for the pricer is to ensure that, at 'the sharp end' (*i.e. within the sales force, at the point where customers encounter the prices the Pricer has helped to set*), there is an optimum level of:

- Familiarity with the firm's P&L structure, and an awareness of the dangers of discounting,
- Following-on from this:
  - The skill to calculate the impact of any contemplated volume/price deals on the firm's bottom line and when considering giving a discount the firm's representatives know:
  - How to calculate the volumes necessary *just to stand-still* in terms of net profit.
- Tactical skills and negotiating ability.

Additionally, the pricer should militate for the optimum type of compensation package for these frontline people. One that is not rewarded by bonuses on the volumes sold but on the profits they earn for the business. The author, having been a salesman, a sales manager and a sales director, as well as a CEO in his time, well appreciates the difficulty of the latter and the ease of the former approach. But the pricer should also know, and be able to prove the damage to profits that can be done by the former vs. the latter types of incentive scheme.

According to the Strategic Pricing Group (SPG)[v]:

> "The root causes of increasing price-centred negotiations with customers lie both in the way salespeople are paid and sales managers operate. If these two elements fail to promote the proper behaviour or provide effective selling tools, salespeople will quickly revert to the use

of price. The problem is not with the salespeople, it rests with the poor support behind them and their managers."

> *"Volume is Vanity! Profit is Sanity!*
> *But only CASH is Reality!!"* **Anon**

Any salesperson with a volume-based quota or bonus system and with some level of control over the final price, will have a natural incentive to use a lower price so as to 'close the deal'. Customers know and take advantage of this sales behaviour, they would be fools not to. A salesperson who can close a deal at a 10% discount is going to do it every time. The salesperson still gets 90% of their bonus. The problem is that the company often loses 100% or more of their profit on that sale (*see Chapter 6*). This problem can still exist even in bonus schemes that are based partially on profit or gross margin.

Sales targets

Another cause of poor price negotiation practice (*as apposed to the skills outlined in Chapter 8*) are 'quarterly sales targets'. While the need for sales targets is obvious, the question often not considered is: 'What is the cost to our profits of hitting these sales volumes?' Managers who push salespeople to meet periodic sales targets often either force the salesperson to use price to close the deal or, in the case of large accounts, the manager may actually take over the task of closing, and may often use price discounting as the primary tactic. These behaviours totally undermine any systematic approach to the firm's pricing.

Worse yet, these behaviours are often self-reinforcing. They send signals to both sides of the negotiation to continue down the price spiral. Customers often learn to hold orders until the end of a 'sales period' and salespeople soon come to believe that skilful price strategies and tactics are a waste of time and in no way reflect the real behaviours of their sales managers. The end result is a 'cycle of desperation' in which managers drive prices lower and lower to meet their quarterly targets and increasingly sacrifice operating margin to accomplish their volume goals. The author firmly believes that the use of price to close deals should be the exception, not the rule.

The pricer

Perhaps such a situation as above may require that the front-line people should have better sales training specifically on pricing tactics (Chapter 6) and on negotiating skills (Chapter 8), and/or the firm may consider hiring a better quality of representative. One thing is sure, the world is getting so competitive that the 'tactical' ability to implement good pricing strategies is key to the survival of any firm (*except those that generate income from a Monopoly or Oligopoly marketplace*). **Today, that means nearly all of us!**

We are now going to take as given the overall leadership of the Pricing Tsar: Instead, from this point onward we will concentrate on taking the perspective of the person who actually sets the core price for the products. For the larger SME this could indeed be the Tsar, in a modest sized firm however, this could be the product manager, sales manager, or the entrepreneur/owner of the business. Whoever – the question now is what does this pricer person have to know and do to be a success at the game?

The Pricer must ensure that they are kept in the picture with respect to the '**10 point must-know list**' issues of the marketplace as set out above. The market, left to itself, will tend to 'commoditize' products – as we shall see in Chapter 2, this state of play is unacceptable to most market players, and this tendency must be vigorously resisted at all times.

In addition, the state of the market with respect to the stage of its life cycle, and (*if applicable*) the stage of the product on its 'technology adoption curve' must also be known and understood.

With this information and given the Pricer's understanding of the issues, internal and external, they should choose which internally based process for setting price they should employ as a starting point. Although it should never be employed on its own, there is nothing wrong with starting the price setting process for a given business, by using a 'cost plus' approach. As we shall see, it has served business well for more than six thousand years already, so it must have something going for it. In the final analysis any failure to cover costs spells catastrophe. Indeed, for the very small firm with a limited range of products and processes there is no real benefit in being more sophisticated at this initial stage.

However, for the larger, and/or perhaps more sophisticated firm, especially if it is in aggressively competitive markets, say in the 'service sector', a pricer may choose to employ the ‘activity based costing’ system (*explained at the end of Chapter 3*).

Only the very able pricer or the gambler should countenance employing marginal pricing – it is a seductive idea, which like the call of the siren has led many businesses to their doom.

The break-even point

To do this realistically, a firm’s pricer, and their field sales team, will need to be able to calculate break-even numerically; graphic methods are only for illustrating the concept. There is no substitute for numerical calculation – it is more precise AND the process will yield more information and more insights, in addition to the break-even point alone.

Sales teams should also be encouraged to adopt this skill and be able to check the workings for themselves. For this the firm will need the courage to share (*some of*) this data with (*some of*) their sales force. The data thus shared must be the truth (*whatever the salespeople are told, it must be realized that if they are indifferently motivated, one way or another, they will pass this information on to their customers, and from there you can bet on the data reaching the competition. So, although whatever you tell the sales teams must be the truth, remember, you don’t have to tell them ALL of the TRUTH!!*). We encounter this issue of calculating BE in Chapter 3, and especially in Exercise 3.4.

Items 1, 2 and 3 in the 10 point must-know-list of issues shown above, are the next consideration for the Pricer. How do you meet the market price and be profitable if your business model is no better than the competition’s and therefore your costs are no better than par? (*E.g. the ‘South Western Airline’ business model*[vi] *is successful BECAUSE it reduces the costs of running such an airline to a shadow of the costs incurred* ***by their competition, i.e. the mainstream international carriers***). If, as may be the case in most circumstances, we seem to be at the point where we cannot squeeze any more costs out of our business, and even if we can it will take time to apply or to work through the system; our attention should focus on our marketplace, and the prices of our competition. To beat the competition will require pricing that will provide a profitable ‘competitive edge’. Hence a ‘price positioning’, plus a sound pricing strategy must be created that will be attractive to our customers whilst still being profitable to our business.

So, on to the next part of the jigsaw, the pricing process: Getting to grips with our target customers!

Assuming a free and open market, no given package of price and value will appeal to all customers simultaneously. So our pricing must be aimed at specific sectors of the market.

If we are in business-to-business markets (B2B) there are often occasions where we can tailor our offering and our pricing uniquely for a specific customer. If however, we are closer to the consumer, even though we may have to go via distributors, retailers et. al. (i.e. B2C), it would not normally be possible to deal with each individually.

In this situation we must cluster our customer types so that each customer has many relevant similarities with others in the cluster, and in respect to these factors are dissimilar to other customers not in that cluster. This is known as 'Segmentation',[vii] (*we discuss this early in Chapter 4*). Thus, optimally, each pricing strategy should be focused on a specific customer segment.

Price positions

The way we address that 'target' segment is often referred to as our price position. So what is our current perceived price position in our market?

Are our prices high, medium or low when compared to those firms competing for the same segment? Everything is 'relative' and in this case our prices are relative not only to the competition, but also to the value we provide for the prices we charge.

For each of our price points, we must be seen by our customers either to provide value commensurate with our price, or more value, or less value. The answers to these issues are plotted on what is known as the price position matrix (Chapter 4), which is a three cell by three cell matrix of price versus value (*as perceived by the customer*!). Later this concept is refined into a matrix of six-by-six-cells and is referred to as the 'Price/Value Landscape Grid' introduced in Chapter 4 and which is employed in the process of 'value-based-pricing' as set-out in Chapter 5.

These grids form an essential foundation to any pricing strategy. Once they are in place they should be kept-up-to-date via a sound customer/market information system (C/MIS)[viii].

Now we can start to compile a pricing strategy. The essential first stage of any strategy formulation is to ensure that we are clear about the aims and objectives to be achieved and that these are concise (*'too many and you don't have any'*), unambiguous, clear and SMART[2].

There are some twelve basic pricing strategies with which the Author has become familiar over the years, most others he has encountered are either variations on one of these themes, or are tactics rather than strategies. For example, so called 'value based pricing' is actually a collection of different approaches to adding value to the deal and thus supporting the price charged (*one variant being 'partnership pricing', as explained in Chapter 4*).

As we will see there are distinctive pricing strategies for entering a market, for leaving a market, for keeping the competition out of our market, for launching new products at the start of their product life cycles (PLC) and when well into their PLC, for trying to stop price wars and ones for fighting one if you can't prevent the war happening.

Value based pricing

Chapter 5 takes one particular strategy value based pricing and examines it in depth, because it is such a powerful tool for winning new business and for creating barriers to competitor entry in to our markets. The chapter explores how it works, the process of compiling/tailoring the specific value based price, how to use it and when to use it.

The starting point is customer value: Customers and consumers use goods and services to achieve something of value in their lives and/or businesses.

For business to business, the four levers of financial improvement (Chapter 2) lie at the heart of any value proposition, either singly or in some combination. The firm is either reducing its overall costs (*and our price IS a cost to them*), trying to sell more volume, obtain a good price **from its customers**, and/or optimize its investment – none of which are mutually exclusive.

For consumers, the levers of value lie in some permutation or combination of the five elements of Maslow's hierarchy of needs[ix].

By focusing on what that business value is, and how it may differ from competitor to competitor, businesses are able to accomplish a number of important things.

First, the firms are able to understand how to respond to different competitive situations with customers.

Second, the firms are better able to recommend assemblies of product 'features and benefits' which, when translated into customer 'value' either match or beat the competitor's product's performance and/or their price. This approach forces customers to make choices based on either price or value. Research confirms that, despite what they might say in the middle of a negotiation, most customers prefer value over low prices (*most customers, not ALL, see the three types mentioned and described in Chapter 4*).

Third, the firm obtains insights into new product and service features for which customers may be willing to pay more. This should translate into competitive advantage for the business.

The skill is in attaching a monetary value to our customer's decision to use our products versus those offered by a competitor. This monetary value should be based on specific results for the type of customer (*or segment*) being considered. Attractive products in B2B markets are those that produce either lower operating costs, increases in capacity, free up working capital, create more sales or enable our customer to charge higher prices to their customers (or any permutation or combination thereof).

Credible supporting documentation can make these values tangible to both the salesperson and their customers. Such documents help our salespeople to ask questions that are relevant to their customers and to elicit favourable responses from them. Such material should help identify how the customer will improve their business' performance as a result of adopting the right good or service from our business. These tools can be complex, web-based analytical programs or simple spreadsheets formatted to accept customer inputs and provide timely calculations of value and return on investment.

Not all customers behave the same way: There are considerable differences between customers in how they choose to approach their relationship with their suppliers. 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 through the same tough bargaining process as they do for low-value suppliers. They do this in the hope that the high-value vendors will be intimidated into providing their higher value products but at the lower price. This sort of environment should encourage our salespeople to gain the skills to diagnose these customer behaviours and develop the appropriate approach for each.

Generally, customers employ one of three likely purchasing agendas when dealing with B2B suppliers:

- **Price buyers** drive to obtain products and services at the lowest possible prices. This includes qualifying many vendors to ensure an aggressive price battle for their business.
- **Value 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.
- **Relationship buyers** rely on vendors to help them understand and apply the offering and are willing to pay higher prices for those skills and expertise (*see Figure 4.5 et. seq.*).

When planning for the account the wise sales person should identify the likely behaviour of their 'target customer' and address this with an appropriate package of offerings. They should also adopt some well thought-out negotiating tactics to minimize the damage of 'price buyers'. Or perhaps worse, those 'value buyers' who have learned that they can get lower prices for higher value products by masquerading as a 'price buyer'. The really effective sales person knows that any single approach will not work for all their customers.

The skill is in creating approaches to negotiation that expose 'procurement's' true agenda, whilst having a proposition ready that will minimize the damage that the totally price oriented buyer can do.

It is perfectly acceptable to sell low price, low-value products if they fill our capacity with a useful contribution to our bottom line. The firm's pricing skill must ensure that their product range includes those products where the specific 'features, advantages and benefits' on offer are organized in a portfolio of low-value, medium-value, and high-value so as to match the typical agendas of each of the three different sorts of customers they can have. This, whilst simultaneously keeping in place the firm's approach to profitability.

A key to this process is to present what our firm offers with the appropriate 'fences' in-place to ensure that low-price oriented customers are prevented from getting access to high-value goods and/or services.

Sales planning for price

So, following on from the above: **sales planning and preparation are critical for successful pricing.**

Pricing is implemented in the offices of purchasing agents around the globe. A well-prepared sales force understands that advanced analysis and planning is essential so as to shift the discussion from price to value. **And that not all customers are willing to make that shift.** To be successful, salespeople need to prepare for all negotiations at three levels:

1. **Strategic**: Allocate resources where they can return the highest value to the organization
   - What is the relevant background data about the account?
   - How do our products create value relative to competitive offerings?
   - 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**: by analyzing the research, how should the sales representative meet account objectives and develop plans for the following:
   - What is the customer's likely buying behaviour?
   - Given this behaviour, how best should our key executives be employed in the account?
   - What 'product packages' should our people plan for a given customer?
3. **Negotiation preparation:**
   - Following the analysis above, how should the team position and package the proposal?
   - What do we expect the customer's response to that proposal to be? This may be a guess, but it provides understanding of what product package is best and what approach may work
   - Given that response, what should our back-up approach be?

Conclusion

It's clear that improved sales planning and execution leads to more revenue, profits and customer loyalty. This planning must link the right value package to the right customers and do so in a way that suits their business needs and buying behaviours.

Effective value-based programs protect the firm's value packages and sell value to the customer, which only happens if firms have low-value 'fighter-brands' (*see Fighting a price war,* Chapter 7) with which to engage the low-priced competition.

In addition, our sales teams should have the necessary training and tools to support their understanding of the firm's market position and the value of these offers, plus when and how to use each different element. In addition, salespeople should be helped to develop the sophisticated skills necessary to understand the customer's business and their customer's value chains including how these operate. They should know how their products apply to those operations and how they provide a differential value advantage over the competition.

***'Selling is not telling!'* it is asking questions in the customer's language and listening to their response.** Only then can our representatives craft a specific product and sales solution to assure success with the account.

Managers who support the above process by developing comprehensive programs of value creation and 'value matching' will be successful. These programs should aim to help our salespeople to 'stick to their guns' when they are in complex and difficult negotiations. This is not easy, but it is the only way to gain the initiative in the value exchange process with our customers.

Tactical pricing

In all value exchanges, there are tensions as to who is getting the better part of the deal.

Both sides will try their uppermost to ensure that they are not the ones that 'end-up with the shorter stick!' Thus there is a need for those in the front-line to be tactically competent, and be able to negotiate the best 'win/win' deals. (*Tactics are dealt with in Chapter 6, and Negotiation in Chapter 8.*)

Tactically the salespeople in the firing line must not only be conversant with the dangers of discounting, e.g. that say a 10% discount **can** wipe-out the firm's net profit if not compensated for via larger volumes purchased by the customer in return for the discount given; but how much for how big a discount, that's the question. In Chapter 6 we provide not only the background to this dilemma but also three ways to calculate this situation, especially useful when 'under fire'.

In addition, Chapter 6 addresses such issues as:

- General discount policy and practice
- Pricing in a declining market (*what will be the long term implication on the business of any change in price*?)
- Pricing at the different stages of the product life cycle (PLC)
- Pricing a new product in a totally new PLC, things to do, and not to do
- Pricing when launching a new product into an already established market and PLC which requires a wholly different set of tactics which we discuss
- Bundling vs. Breaking (*to add value or not*?) during the various stages of the PLC.

Chapter 6 also examines the central rules in 'tough times' which centre around the need to preserve our gross profit and doing so via adopting 'business process outsourcing' as a part of our firm's business model. This enables the business to change many of its fixed costs into variable costs, and thus, in the process changing the nature of the breaking-even for our business.

In this theme the chapter goes-on to examine the dangers of 'marginal pricing' – which are many, apart from the frequent issue of not reaching overall break-even during the financial year, and thus putting the business in jeopardy. In this discussion we also examine the rules of marginal pricing which are for "***the adherence of fools, but the guidance of the wise***". That is to say if you have to employ marginal pricing – this is the way to do it. Towards the end of that chapter we also examine the various considerations for responding to the invitation to tender. We say that if this invitation is the first you have heard of the project, in all probability you are only making-up the numbers (i.e. the 'required 3 tenders' etc.). During the discussion of this topic we examine briefly a method for estimating the probabilities of winning the tender against known and studied opponents. We then proceed to an examination of how best to present your tender both in document form and personally, if you have the chance to do so.

The remaining Chapter 6 contains a set of stratagems and paradigms (*i.e. 'rules of thumb'*) for putting up the price of our products, how best to do it for the general market plus how to preserve our key relationships with major accounts. This discussion also includes ways to put up price – without appearing to – some ways of which are not available to all businesses, but when they are available to us they will make all the difference.

Price wars

In Chapter 7 we examine price wars – things to avoid like the plague. If our business is a large player in its markets then the best way to deal with this situation is to do our damnedest to ensure that they don't break-out if we can possible help it.

This chapter uses the price war between three broadsheet newspapers in the UK, in the mid 1980's, to provide an example of how they can happen and how they rarely achieve the objectives set by the belligerents.

The first part of this chapter examines the prophylactic regime we need to employ to prevent price wars ever breaking out in the first place. One major issue stemming from the fact that most price wars are caused by our customers, rather than by our competitors, is that we must learn to recognize when the client is lying. They admit to telling some ten to twelve lies in the normal course of business anyway – and these are detailed in that chapter.

We also examine the market conditions which can create the potential for commercial conflict, and set-out a series of symptoms for which we must keep 'a weather eye open'. It is also important to understand the necessary conditions for a belligerent to be so inclined, and we set-out these situations to act by way of being 'trip-wires' for our surveillance of the marketplace, which when 'tripped' should alert us to the potentially dangerous situation in our marketplace.

The regime for analysis to identify where the threat is most likely to originate is:

Firstly, to identify those with the muscle and motive. To a large extent this will depend on the firm's size. At one end of the size spectrum, the market leaders have much to lose by going to war, whilst the smaller niche players have little muscle and few resources with which to benefit. It is the middle sized players that can harbour the threat – the chapter uses a graphic (Figure 7.2) to illustrate that it is the market 'Princes' that are the ones to watch, not the small fry.

Secondly, the pricer must evaluate the opposition's potential strengths and weaknesses (Figure 7.3). Do these mid sized competitors have the lean and hungry look about them, or are they content to stay where they are? What sort of culture do they have, are they effectiveness focused or are they focused on efficiency?

Thirdly, as we see (in Figure 7.4) how do the opposition manage their business at this moment? Are they acting realistically, with clear strategies and objectives that seem logical and well thought-out and executed, or do they have more resources than they currently need? Are their objectives ambitious? Do we find that they are unpredictable and also copying our products, market moves and finally your prices? If the latter, as Machiavelli would say, *'keep them closer to you than your dearest friends'* in order to avoid the surprise attack.

And if you have to fight, then do so without mercy. Chapter 7 concludes with a distillation of the rules for fighting any war. The only difference is that in a price war, at least in the west, no blood is spilt, but nonetheless people can still lose everything they have built-up over the years. There are some 4,000 years of recorded conflict available, all over the world, so Chapter 7 draws on the various sources for its shibboleths, from Sun Tsu, through Alexander, Hannibal, Caesar, and Napoleon to Clausewitz.

Finally this chapter introduces the stratagems of the fighter brand and the diverter which are commercial applications often used successfully by the virtuoso pricer.

Negotiation

If our business is retail, then, unless we are in the Mid to Far East, we will not have to bargain or negotiate the price with our customers directly. However, for the rest of us, who are either in the business to business value chains, or are close to the business to consumer outlets, then everything is negotiable.

Negotiation is not bargaining. Bargaining is just one stage in the negotiation process.

In Chapter 8 we take an overview of negotiation and the processes associated with it.

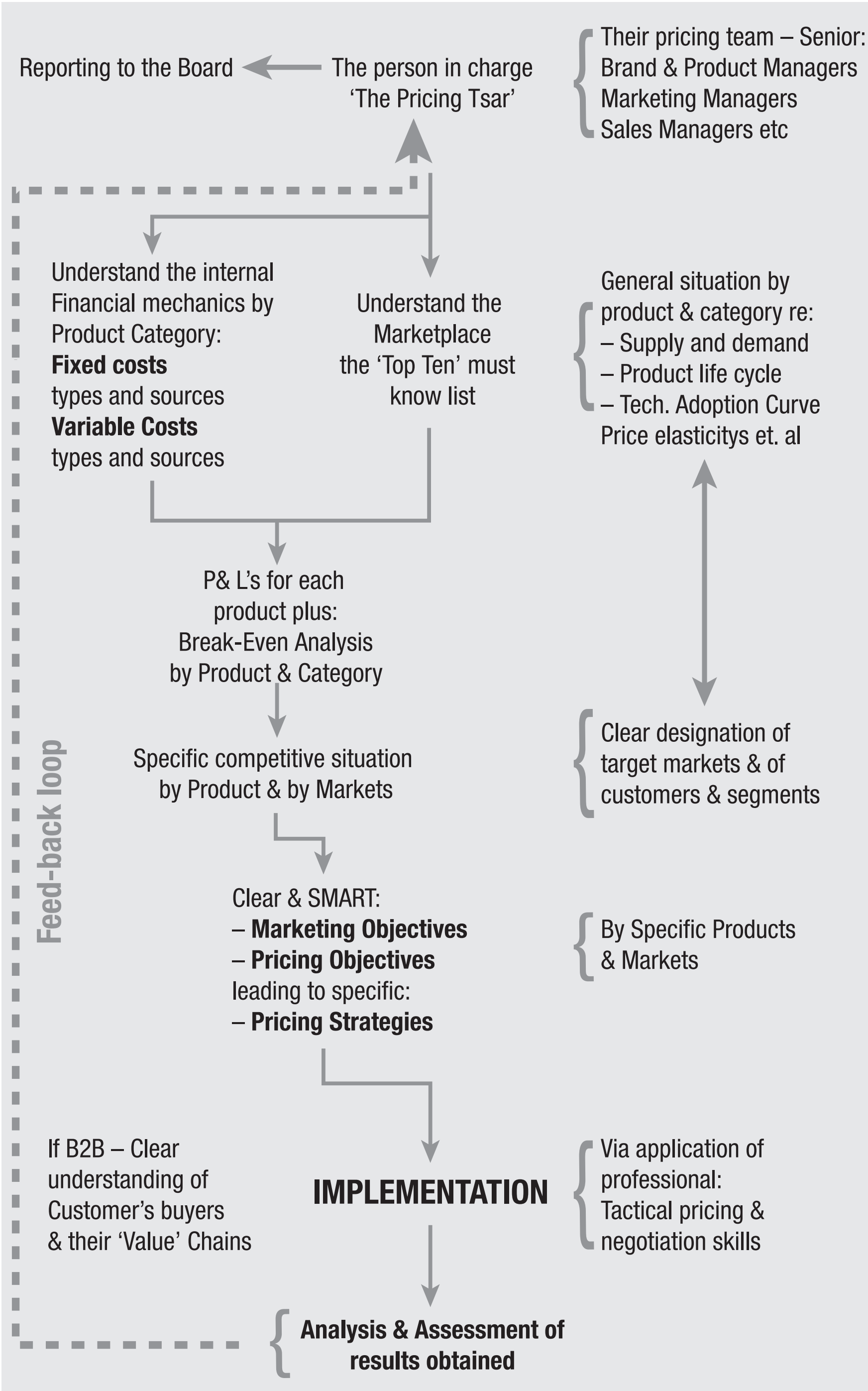
The negotiation sequence is to:

- **Prepare one's ground:** preparation in negotiation, as in much else in life is the mark of the true professional. And in the negotiation meeting the aim is to:
- **Discuss** with the other side the situations, re their objectives and room for manoeuvre, then
- **Propose** a deal, as the starting point of the
- **Bargaining** process: and when the two sides are approaching a consensus – the aim is to
- **Agree:** and don't forget to spell everything out. Agree what you have agreed and do so in writing.

Finally, when the process is concluded, never let the other side know what they could have obtained. The best negotiations are when both sides feel they have accomplished all that they can, and that both sides were fair and worth doing business with in future.

Negotiation is not an easy skill to acquire – it requires practice and experience to do well.

The reward for being an accomplished negotiator is that it is applicable to many other pursuits in business and in one's personal life. But in business it is a critical part of getting the right price, making a reasonable return on the investment, and so living to do it all again another day.



FLOW CHART OF THE PRACTICAL PRICING PROCESS

References

1 **S**mall to **M**edium **E**nterprise.

2 **S**pecific, **M**easurable, **A**ctionable (and/or) **A**greed, **R**ealistic, **T**ime-Bound (i.e. deadlines).

i According to Yehudi Menuhin a discipline is said to be the combination of an 'Art' and a 'Technology/Science'. In Pricing this is the Technology of cost control and internal financial management combined with the art of foreseeing sales volumes and profits arising from the options faced by the firm.

ii This exercise was one beloved of the Author's original Pricing Mentor, Roy Hill and has been used with his permission, by this Author, on every pricing course/consultancy since we worked together at the Chartered Institute of Marketing back in the early 1990's.

iii Another word for gross profit as we will see, which has its uses in the internal battles over price within the larger firm.

iv An unstructured market is said to be one where it takes more than 20% of the firms in the market, to account for 80% of that markets business i.e. it is very competitive. A structured market is the opposite.

v Adapted from a paper presented by Reed K. Holden of the SPG in 2003.

vi The main business model used by the low-cost carriers througout the world such as easyJet, Ryanair, AirAsia et.al.

vii See also '*Mastering Marketing*' (2nd edition, 2006), and '*Marketing your Service Business*' (2006) both by this Author and this Publisher.

viii Again see C/MIS in '*Mastering Marketing*' (2nd edition, 2006), by this Author and this Publisher.

ix For an excellent paper on this topic visit the Author's website **www.ruskin-brownassociates.com** and download the PDF of this concept which you will find there.