

The Hidden Cause of Vaporizing Profits

WHITE PAPER

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If you are like most executives searching for incremental profit, you'll find it hiding in plain sight. Look no further than the internal—and often territorial—negotiations between your Sales and Pricing teams. Salespeople want the best prices for their customers. Pricing wants to maximize profits. Both groups have shared responsibilities and rewards, but vastly different perspectives. If they don't work together effectively, profits vaporize.

Sales leaders feel their teams are doing the best they can given tough market conditions and pressure to achieve top-line revenue goals. For another point of view, speak with your pricing leaders. First, ask for a gut check on the general reaction of the salespeople to your pricing. Next, suggest tracking the deal price impact when salespeople begin posturing for deeper customer discounts. The intensity of haggling for lower prices reaches a crescendo as desperation escalates to close deals at the end of the period. This scenario replays constantly.

Consider the combined financial impact on profitability of three proven facts:

1. A 1% reduction in price results in an 11% loss in profit.
2. Procurement uses well-practiced tactics to reduce prices with an average target of 20%. (We call this “playing poker” because it’s just a bluff.)
3. Procurement people are surprised how often they get the 20% from salespeople.

Apply these facts in considering this case: As the year-end approaches, a supplier to the financial services industry receives the typical procurement letter claiming cost-cutting needs of 20% on current products and services provided for the upcoming year. The supplier's contract with the customer is worth \$10,000,000 with 9% margin. If the requested amount of 20% is negotiated at 10%, easy math indicates the contract is now \$9,000,000. Sales celebrates retention of a happy customer. The cost-to-serve often remains the same, although the 10% new price discount results in a 110% reduction in profit; the supplier is now conducting business at a loss with this customer.

Examine the causes of chronic discounting occurring in most firms:

1. Salespeople lack a clear and defensible rationale for the given price. When they get price justifications, they don't believe them. They think prices are inflated intentionally to offset some of the habitual discounting, causing further distrust.
2. Many organizations embrace the myth that generating more revenue translates to more profits. This belief encourages salespeople and their managers to lower prices to close more deals. Without the proper governances in place, higher sales goals only lead to an overreliance on more discounting.
3. Most sales compensation plans reward top-line revenue with little to no regard for profit. This approach provides plenty of incentive for salespeople *and their leadership* to offer deep discounts. Even programs that include a portion of profit in the incentive program struggle to control discounting at the end of the quarter as desperation takes over to meet the sales numbers.
4. Customer procurement people and other savvy buyers have learned that if they "play poker and bluff" about their cost constraints, lower competitive bids, and express a supplier's lack of value, salespeople fold and offer a discount every time.

During recent interviews with the sales team of a large global technology company, we learned that it never held to the quoted price despite the company's high value and lower quality competitors. It soon filed for bankruptcy.

Another client had established numerous approval thresholds intended to curtail discounting. Salespeople regarded these levels as navigational starting points. Beyond these initial gates, salespeople learned indiscriminate pricing exceptions were automatically approved with a formal submission request. A quick discussion with the CEO solved the problem and dramatically reduced the overwhelming number of requests.

Gain control of your profitability by:

- Putting a pricing infrastructure in place to gain accurate and efficient visibility of current discounting behaviors.
- Developing tiered product and service offerings with trade-offs that keep cost-to-service in line. Salespeople then have something with which to negotiate other than price.
- Teach salespeople how to align the price of the offering to the financial value delivered, demonstrating confidence in your differentiation. Stress the importance of understanding what each of your customers values from doing business with you. Otherwise, those accounts are at risk.
- Move Sales from a revenue to a profit focus and teach them how to deal with the high-pressure, profit-eroding tactics they are facing from tough buyers today.

Firms in the quest for market-share gains at any cost continue to have trouble capturing vaporizing profits. Fortunately, those that find their way realize dramatic increases in both revenue and profit.

About Holden Advisors

Holden Advisors are thought-leaders in B2B pricing and executing price through the sales force. We have years of experience helping companies understand customer value and hone their internal capabilities to price, market and sell based on the difference they make for customers. We teach our clients to understand value from their customers' points of view and craft solutions to meet customers' evolving needs. Our proven methodology drives improvements in close rates, ROS, margins and cross-functional cooperation.

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About the Authors



Dr. Reed K. Holden is Dr. Reed K. Holden, Founder of Holden Advisors, is a world-class pricing expert who helps clients build go-to-market strategies to drive price leadership, selling backbone, and profitable growth. Dr. Holden published the 2nd edition of *Negotiating with Backbone: Eight Strategies to Defend your Price and Value* and co-published *Pricing with Confidence: Ten Ways to Stop Leaving Money on the Table*, a top selling pricing book for the executives.



Chris Mitchell has over 25 years of experience in sales tactics and strategy development, sales management consulting, marketing alignment, sales process, and performance improvement. She has been devoted to marquis brands in healthcare (including PBMs), logistics, transportation, office imaging, professional services, and the manufacturing industries resulting in measurable increased performance. Specifically, Chris has worked globally with clients to launch new products; design and deliver client national sales meetings; integrate sales and marketing functions around a common go-to-market strategy; enhance field coaching; optimize value propositions with improved consultative selling skills initiatives; develop sales processes and certify scores of client trainers.