Gordian Business
Growing B2B Results through Value©

How to fight price pressure.

Gary Peacock
Author of: Managing B2B customers you can't afford to lose

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Discounting is not the answer: Compete With Value

Contents

Introduction

Most managers know discounting price reduce profits because companies cannot increase volumes to compensate for the discount. Discounting prices damages customers perception of value of products and services.

Companies make mistakes when they feel that their market share is threatened. Their first response is usually to discount prices. However, this often dilutes the value that could have been retained despite the increased competitive pressure.
Some companies accept discounting prices as the only way forward and the spiral continues downwards.

However, this trend can be reversed when companies spend time revisiting their value propositions for their major customers. Focusing on communicating clearly the true and often unique value of their products and services.

For many B2C companies it is too late to scramble out of the discounting wars, and B2B companies are following closely on their heels. However, some brands still have a choice: engage in a discounting price war to the bottom or seek to do what is unique and intensely customer relevant. Then price is not the determining factor in the customer's decision.

Managing relationships with your top customers and solving their most difficult business problems are important ways to take the pressure off price. By building a solution for your top customers you are also building a barrier to competitors. When your top customers know that you are in it with them and for the long-haul, your relationships will transform and your value take precedence over your price.

What causes price pressure?

Customers have more choices and companies have to get their messages heard in a busy marketplace. Because many companies are poor at selling their value compared to other companies, customers see products as commodities. When customers see commodities, they make decisions on only one thing: price.

The retail environment has experienced dramatic change. The average retail space has more than doubled as the big box retail store was born: stack-them-deep and sell-them-cheap

This business model offered customers fewer services, no frills but guaranteed lower prices. Everyday low prices were now deeply etched in the minds of customers.

As well as this was the internet revolution of the 1990's which changed how we shop. Customers have more information than ever before, with reviews and comparisons at their fingertips.

Robert Nadeau from Industrial Performance Group explains this concept well in this article.

Overcoming Price Pressure

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How can you overcome price pressure?

You know discounting reduces profits but how can you be heard in a noisy marketplace.

To defend higher prices you need to communicate value using the same language that you use to communicate price – dollars. Value has too often been communicated using soft language like – dependable, superior value, prevents, allows.

When we don't use the language of money, it's tough for your customers to judge if they are getting more value than price.

So, customers do what's easy for them: focus on price.

There is hardly anything in the world that some man cannot make a little worse and sell a little cheaper, and the people who consider price only are this man's lawful prey.

John Ruskin

You can overcome price pressure when you focus on the value you provide your customers. There are some questions on the next page to help you prove the value of your offer.

Some Questions:	What is the money value($) they will realise …
Can you help your customers improve productivity?	from better use of labour, equipment, and materials?
Can you help customers reduce costs?	from reduced materials, energy and consumption?
Can you help customers increase sales?	from increased prices, selling more units or getting new customers?

Knowledge is of no value unless you put it into practice.

Anton Cheknov

What is total cost of ownership?

"Getting a reduction in price is an immediate gain, while buying on total cost is a long-term proposition. The savings suppliers claim from total cost buying are all smoke and mirrors". Purchasing Quote

Anyone responsible for purchasing from suppliers will have thought or said this more than once. This is partly due to the interchangeability of the terms 'cost' and 'price'. Many assume that buying on reduced price will yield savings that increase profitability. In reality, however, these savings rarely occur. When more rigorous measurements are applied, the true potential of buying on total cost becomes clear. According to a study by the Manufacturer's Alliance for Productivity and Innovation, companies that choose and measure suppliers based on total cost are 35% more profitable than ones that do not have a formal plan or focus on price-based components.

Best-in-class companies have shifted their way of thinking and now buy from sellers who offer the best total solution and terms that maximise economic benefit – a company that can back up their benefits with real numbers, so it's easy to get management buy-in.

Purchasers are beginning to realise that price is only one component of the total cost of ownership, and usually the smallest.

There are four stages of total cost of ownership and each stage has it's own impact points.

1. Design
2. Acquisition
3. Installation, Operation & Maintenance
4. Disposal

Four stages of Total Cost of Ownership.

Design

When the product is created and the costs are determined. Determinations about how the product will fail, how much it will cost to fix, the probability that it will fail, what it's operating and maintenance costs will be and any disposal costs.

Installation, Operation & Maintenance

How easy is it to install and start using? How much energy or lubrication will it use? If it fails, is it a simple fix or catastrophic event with high costs? Can failure be predicted enabling planned maintenance?

Acquisition

Additional payments associated with a deal are added in at this stage, such as taxes, shipping or receiving costs.

Disposal

Costs are usually minimal for this phase, but for some products they can be very high, such as lubricants.

This article by SKF Group, experts on value-selling, explains total cost of ownership in more detail:

Lowest price ≠ Lowest Cost

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Nothing can have value without being an object of utility.

Karl Marx

A 2001 study by Accenture Group showed that the initial purchase price of a mechanical asset will only account for between 8-12% of its total cost of ownership. For industrial equipment, this means that between 88-92% of the customer's costs are realised while they are using and disposing of the machine.

Based on these assumptions, some companies will spend more time and energy trying to buy a machine that meets its minimum specification for say 10% less than another option. In reality, that 10% price reduction during the acquisition phase would only cut the total costs of ownership by 1.2%.

But, if it were to pay 10% more for a better machine that cut costs by 2% - by being easier to install, lasting longer, using less energy etc. This would effectively have almost a 50% reduction,

Small improvements in operations can have a big impact compared to seemingly large price savings.

Many companies are now looking to partner with a select few suppliers who can look at the complete picture. Suppliers who can identify how their products or services will affect their customer's operations, and can make specific recommendations for improvement. Such improvements can add substantial value to the bottom line – much more than the relatively small gains from price concessions.

When the buyer and supplier join forces to create value together, the pie is bigger and there is more to go around for both parties.

You don't get paid for the hour. You get paid for the value that you bring to the hour.

Jim Rohn

How can you communicate your true value to your top customers?

To communicate true value you need to change to be more customer-centric that shows the full value of your products and services.

A Mckinsey report on Semiconductors in Autumn 2011 showed that a value selling approach added between 2-4% to average selling prices, which grew to 6-8% in the second year if customer insights were fed into the design of new products. For further guidance on customers insights check out our eBook:

How Well Do You Know Your Customers

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To sell using value you need to understand the true value of the product to your customer.

Most customers think of value as the benefit they receive directly from a purchase. They rarely considered the indirect benefits, such as switching costs or infrastructure savings.

Most companies expect current prices to determine future prices. If there's no change to the product then expectation is that price increase should only rise with input costs rising.

Identifying value to the customer

Uncovering customer purchasing criteria
Research your customers to find out what is important to them. Start with interviews that determine the elements that matter most to your customers and understand how these are prioritised.
This will produce:

- A list of factors important to your customers
- A ranking of these factors in importance to your customers
- An assessment of company performance against these factors.

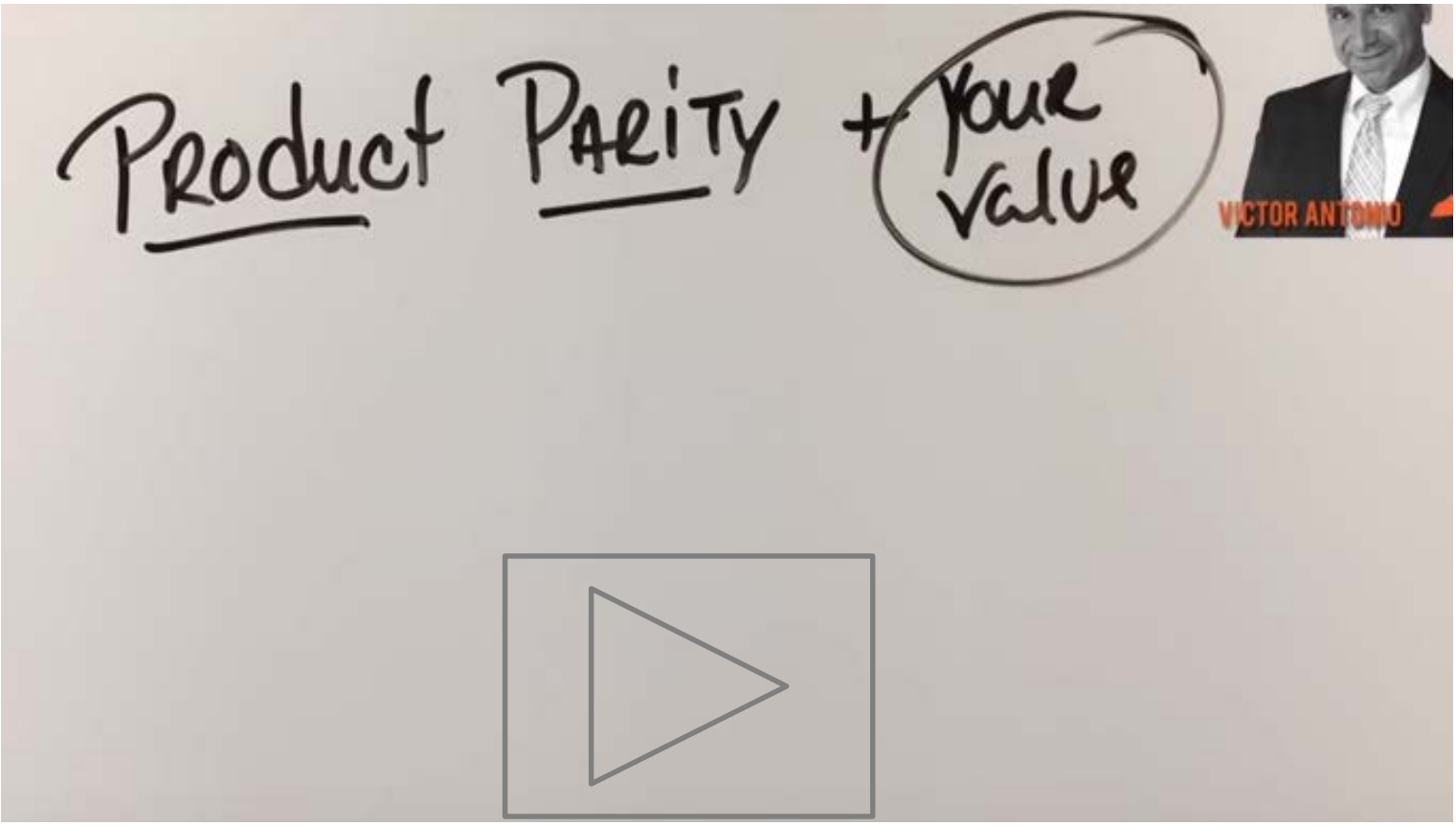
If it saves me development cost and improves my time to market by *x* percent, I am not going to go for a cheaper device.
Customer Quote

Researching your customers can be done with executive interviews, through online surveys to a broader range of your customer relationships and through searching online for all published documentation.

Executive Interviews LINK

Customer Research & Surveys LINK

This video by Victor Antonio *How to sell Value Not Your Pricing*, shows how to identify and explain what differentiates you from your competitors. Providing this perspective and insights allows you to justify your price and the value you supply.



Strive not to be a success,
but rather to be of value.
Albert Einstein

Building value selling capabilities in your sales team

Co-create the value propositions for your customers, managers and sales team. Experienced sales people understand the dynamics of their marketplace and can use their expertise to improve the value proposition. Also, if the sales team are involved in creating the value proposition then they are more committed to it's use. However, for a new approach it is essential to have executive sponsorship, the head of sales, to be successful.

Why is executive sponsorship so important in change initiatives?

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Communicating quantifiable value to your customer

Not all customers are the same, some may share a set of value drivers while others find different value in the same attributes.
Good value selling empowers salespeople to identify the type of customer and to generate the most convincing value proposition for them. So, the sales team can adapt without having to improvise value propositions for each customer.

A leader is one who knows the way, goes the way and shows the way.

John Maxwell

Locking in change by tracking performance

It is important to have metrics to track the performance of your new value selling program. What gets measured gets done. It is essential to track progress and assess your sales team's behaviour regularly.

For more in depth insights into value selling and communicating your true value check out the McKinsey article below: *Getting customers to say, "The Price is right!"*

Getting customers to say, "The Price is right!"

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Long-term versus Short-term?

Companies with a long-term approach can get superior performance for revenue and earnings, investment, market capitalization and job creation.

A survey by FCLT Global (Focusing Capital on the Long-Term) from September 2016 shows that executives are feeling pressure from short-termism.

Surveys show that executives are feeling pressure from short-termism. Executive and Directors …

87%

feel most pressure to demonstrate strong financial performance within 2 years or less

65%

say short-term pressure has increased over the past 5 years

55%

at companies without a strong long-term culture say their company would delay a new project to hit quarterly targets even if sacrificed some value

The survey shows the following findings, as summarised in the McKinsey reports:

From 2001 to 2014, the revenue of long-term firms cumulatively grew on average 47% more than the revenue of other firms, and with less volatility. Cumulatively the earnings of long-term firms grew 36% more on average over this period than those of other firms, and their economic profit grew 81% more on average.

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Where companies with a long-term view outperform their peers

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Measuring the Economic impact of short-termism

Long-term companies exhibit stronger financial performance over time. On average, their market capitalisation grew $7 billion more than that of other firms between 2001 and 2014. Their total return to shareholders were also superior, with a 50% greater likelihood that they would be in the top 25% by 2014. Although long-term firms took bigger hits to their market capitalization during the financial crisis than other firms, their share prices recovered more quickly after the crisis.

Long-term firms invested more than other firms from 2001 to 2014. Although they started this period with slightly lower research-and-development (R&D) spending, cumulatively by 2014, long-term companies on average spent almost 50% more on R&D than other companies. More important, they continued to increase their R&D spending for long-term companies. This grew at an annualized rate of 8.5% versus 3.7% for other companies.

Chicken or Egg Scenario

An article in The Economist *Corporate short-termism is a frustratingly slippery idea* suggests it's difficult to identify the cause of short-termism.
Do short-term firms become weak or do weak firms rationally adopt strategies that might be judged short-term? In any industry it is natural that some firms stagnate or decline while others expand.

Read the article in the Economist and see what you think:

Corporate short-termism is a frustratingly slippery idea

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To be or not to be, that is the question.
William Shakespeare

What’s in your Value Proposition?

Across most industries, companies are finding that their traditional value proposition is falling short.

In the past, some companies have been able to survive and thrive without offering much additional value. Particularly companies with complex products and services like IT companies.
However, this is changing. Industry and technology changes are threatening all companies, including IT companies. To gain or retain customers, new competitors are increasing price pressure. Companies must be able to demonstrate value, they can no longer rely on their brand or their customers aversion to risk.

Decisions are not being made by technical and operational staff, although they remain influencers. Senior executives and procurement departments are now the decision makers. So, companies must be able to demonstrate value and return on investment in dollars, while delivering excellent service and support and actively managing relationships at all levels of the company.

In today's highly competitive environment, companies need to hunt for long-term competitive advantages. To rise above price pressure, successful companies are employing strategies based on their competencies and expertise. They build strategic relationships with their accounts where the product becomes almost incidental to the relationship.

Companies that engage in real strategic value can charge a higher price for their products and services, or they will not need to reduce their prices as much as other companies.

Companies offering strategic value often charge higher prices because the value they deliver to customers – in the form of increased profits to their customers – routinely exceeds the price premium they charge.

Don't fall into the trap of assuming you are a commodity. Find a way to differentiate yourself from your competition, this will provide you with competitive advantage. The value you offer is only limited by your own creativity and willingness to understand your customer and your company.

The key here is to understand that a value proposition is not merely a product or service; it includes the entire customer experience.

Fred Reichheld

To find out more about fighting price pressure, read our earlier eBook.

Reduce Price Pressure: Provide Value

EBOOK

Why should you build Strategic Relationships?

When companies work strategically and build relationships to deliver joint value, both parties benefit.

Working this way means both companies pursue long-term high profitability over short-term product-price strategies.
Whilst there is often a price premium in these relationships, the cost of doing business is often the lowest in the industry.

The most efficient way to manage your customer relationships more strategically is through Strategic Account Management. These strategic relationships focus on financial objectives and deliver three crucial benefits:

1. They have the majority share of the customer's business.
2. They have a higher profitability with the customer than their average customer.
3. They have first refusal on involvement with the customer on new commercial initiatives.

It is true that you succeed best and quickest by helping others to succeed.
Napolean Hill.

In these relationships the supplier focuses on selling to the customer's customer. The supplier is seen as unique, and can't be easily replaced. By demonstrating better value and minimum risk the customer favours this supplier. In these relationships companies aim to win significantly more volume and deliver higher than average profitability.

The cost of engaging more strategically is higher – in money, time and executive resource. This additional cost is more than compensated for by higher revenue and margins so profitability for these customers is higher than average.
Read more about Strategic Account Management:

Managing B2B customers you can't afford to lose
BOOK

Summary

Price discounting affects the bottom line now and sets an expectation with your customers for further discounts.

Stop the downward spiral of discounting as the only way to deal with price pressure. Identify the unique value that you supply alongside your product and communicate this clearly to your customers. Make sure to express this as a monetary value. Dollar savings are much more persuasive than soft benefits.

Spend the time to calculate the total cost of ownership for your product. Start with purchase price, but include maintenance costs, ease of use, reliability and disposal and replacement. Include all costs for the life of your product in dollars.

> **Nowadays people know the price of everything and the value of nothing.**
>
> Oscar Wilde

Research your customers to discover what areas matter most to them, and how they perceive you are performing in these areas. You can then prioritise your resources to high-impact issues and amend your value propositions to focus on areas important to your customers. When building your value proposition understand the full picture for your customer as you may be able to provide value other than your product or service.

Build strategic relationships with your major customers. Find joint value and expand the size of the pie you are negotiating over during your deal. Expanding the pie will improve your relationships long-term as well as increasing your profits.

We cannot solve a problem by using the same kind of thinking we used when we created them.

Albert Einstein

Questions to Challenge You

1. How do you help your customers improve their productivity?
2. How do you help your customers reduce their costs?
3. How can you help your customers increase their sales?
4. How can you calculate the total cost of ownership for your product or service?
5. How have you established what is important to your customers, apart from what your sales people tell you?
6. Have you created different value propositions for your major customers? What additional value do you include in your value proposition to stand out from your competitors?
7. Do you know which of your customers you should be building strategic relationships with? How did you decide on these customers?

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The Problem

Today's customers are intently focused on getting the lowest price. Customers now have access to everyday low prices, and they now make many purchases from the comfort of their own home or office.

With an extended economic downturn and customers conditioned on price rather than value, what can you do to overcome price pressure.

The Future

Best-in-class companies can charge a price premium because they communicate the value they provide in dollars. Purchase price is just one part of your value proposition. Focus on the additional value you will deliver.

Communicating the additional value you supply in dollars means companies can calculate the value they are receiving against the price they are paying.

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