



The Pricing Dilemma

Unfortunately many manufacturers of B2B products have over time seen their selling prices decline, often to the point where their margins are no longer acceptable. Sometimes their channel partners actually enjoy higher margins on the sale of their products than they do. They now recognize the need for a more structured and profitable pricing policy. This must be done carefully when customers have come to expect that every price is negotiable.

Can it be done successfully? Yes, but it will take 12 to 18 months and require the complete support of everyone in the organization, especially the sales department. Correcting this situation will result in both increased profitability and lower sales costs. Also, if you are a market leader, your competitors will likely follow your pricing lead and you will maintain your market share.

First prevention. How do so many skilled managers and respected companies get into this situation? There are typically four common reasons. They:

- Mistakenly believe that profits and sales volume correlate directly. They do not. Profits correlate more directly with prices than with sales volume.
- Are unaware of the mathematical formula that reveals how many additional units must be sold to recover the gross profit (in dollars) lost by lowering prices. It is:
$$\frac{\text{GPM}\%}{\text{GPM}\% \pm \text{Price Change \%} - 1} = \text{Unit Volume \% Change}$$
- Fail to develop and communicate a meaningful value proposition leaving their market to make purchasing decisions based on price and delivery/convenience alone.
- Reduce prices to increase sales volume. This is counterproductive. The total unit demand for B2B products is rarely elastic. It cannot be increased in a recession by lowering prices. At best you will

provoke a price war which will reduce everyone's profit margins without increasing demand.

O.K., now what to do?

- Your prices must accurately reflect the real value of your products to each customer segment. If you employ cost-based pricing you will quickly get into trouble. Additionally a common B2B pricing practice, "meet competition," is also dangerous because it's based on the assumption that your competitors have properly priced their products.
- Your salespeople must be educated not just on how to communicate your value proposition but also on how to negotiate. Remember they have to negotiate you out of this situation. Harvard, the University of Chicago, Stanford, etc. all have excellent three-day seminars on negotiation. Yes, it's an investment but it must be made.
- Develop of list of valuable non-price "closers" as an alternative to price cuts. Free supplies, extra training, additional services, delivery specials, etc. will help close sales with value-sensitive customers without visibly undermining your pricing structure.
- Switch to a non-negotiable pricing strategy as a promotional tool. The market should perceive any price change as fair for both the buyer and the seller, not as a price increase. This means setting your prices for each product based on its value and not employing across-the-board price increases or reductions.

The Point: If you condition your customers to buy on price they will soon believe that your products are no different than those of your competitors and bid your price down.

In the short-term, employ centralized price controls. Do not allow salespeople to set/negotiate prices. This will free them to pursue their most important task, communicating your value proposition to your target markets.

