PRICING FOR RESULTS

- How to set prices
- How to present prices
- How to discount prices
- How to negotiate prices

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Facts On File Publications
New York, New York • Bicester, England

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Originally published in 1983 by William Heinemann, Ltd., in conjunction with the Institute of Marketing.

Library of Congress Cataloging in Publication Data

Winkler, John.
Pricing for results.

Bibliography: p.
Includes index.
1. Price policy. I. Title.
HF5416.5.W56 1984 338.5'21 83-20630
ISBN 0-87196-849-5

Printed in United States of America

10 9 8 7 6 5 4 3 2 1

PRICING FOR RESULTS

To the stars among my competitors—Aubrey Wilson who taught me how to lead seminars, John May who taught me presentation, Dan Nimer who taught me pricing, Bob Whitney who taught me how to position subjects. And to Heinz Goldmann who showed everyone how to become a star.

Introduction

I believe in market research.

Our research shows us that most managers do not buy many books on management. That will not surprise anyone.

But our research also shows that among those managers who do buy management books, very few managers read them in any depth. What they do, for the most part is to dip into them, select the bits they want, and then put the book in the office bookcase.

This book has three objectives. First, it is for the student who is desperately searching U.S. and British management libraries for a book that tells him how to base his prices on what the market will bear. I have not found another one. Management students read books, because the examination syllabus makes them.

Second, for the practicing manager it has been written according to the results of research telling us what he wants in a book if he is to do more than dip into it. He says he wants it to be readable. We have researched readers' reactions to the open, nonacademic style, we have researched their views on the forced choice questions, on the use of case examples, on the small hints and tips—we have even researched the basis of the title.

Thirdly, the book is designed to address itself to the most difficult pricing questions of the day about which there is a sore lack of appropriate theory. What are the issues of the day? Price wars, how to minimize the damage they do, how to stop them, when to start them. These are issues of the day. You will not have read another book about handling the price war.

The notion of morality in pricing decisions and how it affects business performance is another issue you will not have seen anyone touch.

Whether to allow your sales force to have discretion over setting your company's discounts; how to handle a discount battle; how to negotiate prices—these are relevant matters for the practicing manager.

In a world that is steadily using up its resources at a rate faster than the rate at which they are being replaced, this book devotes itself to the issue that will inevitably become one of the higher things in life—price.

Contents

Instant pricing | 1

The world is full of convenience products: instant meals, instant money, instant information, instant travel.

This chapter represents the world's first instant management consultancy. If you haven't got enough time to read the book, then commit this chapter to heart. Just add water, in a glass with a little whisky.

DEVELOP YOUR POWER

Whatever your sector of the market, be important in it. This is a book about pricing, so follow the old rule: "the strongest dictate the terms."

Become big in your sector of the market, but not at any price. You will get there by offering something new that people want, before most of the others offer it; by continually making what you offer better; and by marketing it forcefully, dedicating yourself to its success without compromise and by pricing it a bit above the average. That is the way to become market leader; you will not get there by giving it all away with lowest prices.

If you cannot be the biggest in the market, then take a smaller sector of it and be the best. Everything that you do, you must do well; your offerings must be superb in quality and finish. You must price them at a premium and market them hard. You will not be the biggest or the richest, but you will make a very comfortable living out of being a specialist.

WORK THE MARKET

Use your costs to give you the bottom line only. Don't use costs alone to set prices. How will costs tell you what the market will bear? Working the market means finding the soft areas where your prices are easier to obtain—normally to be found in the upper quality end, and from the direct customers you serve without going through middlemen, from customers who have money—how can you get your prices if your customers don't have the money? Go behind the professional buyer, because he knows how to get your prices down. Reach his technicians, reach his directors, reach his workers to sell your ideas. They will become excited about your ideas without worrying about whose budget is going to pay for it. They will squeeze their own buyer to buy from you and he will have to pay your price.

Working the market means teaching your sales executives how to negotiate as well as how to sell. They must know how to present price arguments as well as quality arguments.

Figure 1.1
What will the market bear? (an 11-step process)

Step 1
Allocate responsibility

Step 2
Set price policy objectives

Step 3
List decisions to be made

Step 4
Identify influencing factors

Step 5
Review market information

Step 6
Review competitive information

Step 7
Review cost data

Step 8
Establish strategy

Step 9
Set price

Step 10
Set cost and volume objectives

Step 11
Review price performance

WORK YOUR PROFITS

Look after the protection of your profit margins. For every low margin line, you need a high margin line to balance it. Don't go for a rigidly high unit price—because you will not sell enough volume. But don't go for volume at any price either. Work your product mix, be flexible with your pricing, use your price changes to their best advantage. Go for controlled but profitable growth. Keep the business tight, and keep your unit costs always under pressure.

DEVELOP YOUR COMPETITIVE EDGE

Make sure you offer something unique that your competitors do not offer. Promote this difference hard and make sure your customers want this special edge of yours. This will give you a firmer pricing base. When you must discount, then discount, but make sure that your discount policy is well controlled. Make sure you know why you are discounting. Be creative and put a time limit on all your discounts. Don't ever give money away for nothing—discounts must do something for you in exchange. Don't delegate discount decisions down the line to your salesman if you can avoid it. Get the best market information you can; verify it for truth.

Now you have read the instant version, why not go for the full course of home treatments? Read the rest of the book.

How Prices Affect Business Performance | 2

Before reading the chapter, complete the answers to these questions in the spaces on the left-hand side. Then without looking at the answers, read the chapter. Finally, complete the answers again, making any changes you think fit. Score both sets of your answers. This tells you how much the chapter has affected your opinion. Scores are at the end of the book *(p. 193)*.

WOULD YOU MAKE IT AS A TOP BUSINESS MANAGER?

Q.1 *The Secretary of the Treasury is asking for your opinion about how manufacturing industry will respond if he enforces a rigid policy of price controls throughout the economy in an effort to contain inflation. What do you tell him?*
(Check the most appropriate column.)

	Very likely	Perhaps	Very unlikely
(a) *Product quality will be reduced*			
(b) *Some product shortages will occur*			
(c) *Inflation will be contained completely*			
(d) *Bankruptcies will increase*			
(e) *Unemployment will increase*			
(f) *The government will be popular*			

Score ______ *Before reading chapter.* *After reading chapter.* **Score** ______

______ ______

Q.2 *Whenever you study the management accounting figures of companies you plan to buy, you search for one kind of figure first. Which is it?*
(a) Growth in sales; (b) accounts receivable outstanding; (c) ratio of fixed cost to sales; (d) gross profit margin or contribution; (e) value added per employee?

Score ______ *Before reading chapter.* *After reading chapter.* **Score** ______

______ ______

Q.3 *You are in financial trouble. You sell a packaging service for drug companies; you take their pills and give them a coating of gelatin so that people can swallow them easily. Your machines are expensive. Your predecessor bought three new machines but you find you have sufficient work only for an extra one and a half machines. Although you are brand leader, you are working on very thin profit margins due to heavy competition. What action do you take?*

(a) Cut the price to compete with your rivals and to build new sales volume to fill up your three machines; (b) keep to your prices for your customers, but cut back on your other costs. Sell the three machines, get rid of the small customers and all those who are unprofitable; (c) hang on for a while to see how the market goes, but take savings in your overhead. Cut your sales force costs, reduce avertising. Give extended credit to see if this will help to hold customers; (d) sell two machines quickly. Hammer overhead costs such as administration and put extra money into the promotion budget; (e) search for a new acquisition or a new product?

Score		**Score**
____	*Before reading chapter.* *After reading chapter.*	____

Q.4 *Which pricing policy do you prefer, personally? There is no right or wrong answer, but the scores are allocated on the basis of the riskiness of the policy you prefer, and the difficulty of managing such a policy.*
(a) Never knowingly undersold—offering the lowest prices in the market; (b) offering the highest prices in the market; (c) some of your prices are low and you promote these heavily; (d) a price around the middle of the market, offering the same benefits as the market leaders; (e) a price above the main market, but offering some distinctive or unique aspect of quality or service.

Score		**Score**
____	*Before reading chapter.* *After reading chapter.*	____

Q.5 *As CEO, you are presented with four alternative strategies. Each of your VPs is arguing fiercely for his case. You have to make a decision. Which one?*

(a) The salespeople, backed by engineering, want a policy of fast growth. "If you don't invest, you'll die. If we put in three new machines, then we'll get the extra sales," runs their argument. (b) The controller wants to cut the costs of the business by reducing the advertising budget, and by taking other

overhead savings. He says that growth can be met cheaply through working extra overtime with existing resources. (c) The technical people want to push ahead with a radical new development which, if it comes off, could revolutionize the industry. If it fails, the business could be in trouble, but if it succeeds it could be a huge winner. (d) A rather dull plan is also available. It involves cutting back on costs here and there, plus some new investment in machinery, putting some funds in research and development, and controlling the business tightly all the time.

Score			**Score**
____	*Before reading chapter.*	*After reading chapter.*	____
____			____

Q.6 *There are established suppliers to a certain mature market. Which one of them would you prefer to be in order to make the most profit (total cash profit, not return on capital employed)?*

(a) The brand leader with a 25% share of the market; (b) the number two or three brand with a 5% premium price over the average prices paid in the market; (c) the aggressive price cutter; (d) the specialized producer at the top end of the market?

Score			**Score**
____	*Before reading chapter.*	*After reading chapter.*	____
____			____

Scores

Above 25	Good result. You sound experienced.
19–24	Fair. Most people score here.
9–18	Perhaps you are not understanding the questions.
8 or less	You cannot be understanding the questions.

How Prices Affect Business Performance | 2

The city of Antwerp, throughout its history, has relied heavily for its supplies upon ships coming up the Scheldt estuary. The Duke of Parma, while he was besieging that city during the 16th century, found it impossible to blockade the estuary sufficiently so as to prevent food from reaching the noble citizen defenders. He fussed and fumed for a year in his attempt to starve the citizens.

He need not have worried, for the Antwerp city fathers did the job for him in the end, through their misguided pricing policy.

When supplies are short of any commodity which is in strong demand, then the price will go up. Such a law is fundamental, born of man's behavior, not of his legislation. The city fathers interfered with this natural law by bringing in a man-made rule which set upper limits on the price of food. Anyone in the city caught buying or selling food above the market price during the siege was punished, and severely.

The food merchants outside the city saw no profit in running the blockade of Spanish guns in order to achieve the ordinary kind of profits they could make daily in any country market. So they stopped supplying the city. The citizens meanwhile, no doubt pleased to find that food prices remained as stable as in normal times, saw no reason to conserve their demands, nor their appetites.

Ever since man started growing crops, and thereby found the means to stay in one place, he has needed markets. The prices of essential commodities have always been a matter of government interference. There are countless examples of government control over pricing activity which had perfectly laudable purposes but which, in the event, succeeded in producing the opposite effect from that which was intended.

The city fathers of Antwerp wanted to stop their hungry citizens being overcharged by merchants in a strong position. They wanted to ensure that food would be distributed to everyone in the city, not just to those with the money to pay for it. Thereby they hoped to maintain the conditions for a stable community that would be able to resist the attacks of the Spanish.

In the event, the city collapsed earlier than was necessary, much earlier. High prices for food would have conserved their food stocks. As it was, the food continued to be eaten as before. One day, almost without warning, the food ran out. The city surrendered within a week.

Question: *Did the word "twerp" originate with the Antwerp city fathers in the 16th century?*

In any organized market, prices obey certain laws of behavior. It is entirely possible for a government, a company or an individual trader to distort the market by following and obeying some theory of economics such as monetary policy, or a theory of marketing such as penetration pricing, or a practice of accountancy such as standard costing. If the chosen theory does not flow in harmony with the natural process of the market, the effects are always uncomfortable and often calamitous. The imposition of price control policies is nearly always very damaging to an economy.

Yet pricing is at the center of any government's economic policy—these days it is focused upon the control of inflation. Pricing policy is at the root of company philosophy. The average selling price of the material produced, when multiplied by the amount of material sold, produces the company revenue. When the costs of producing the material have been subtracted from this revenue, what remains is the future. The future could be bright with expansion possibilities, it could be clouded by bankruptcy, liquidation or forced sale. The future is dependent upon the equation of Prices times Volume of Sales minus Costs of all kinds.

If you were to examine 150,000 financial ratios from 240 different firms covering seven totally different industries, with the purpose of finding out what is the most important single factor leading to success in business management, you would come to one overwhelming conclusiom. You could look at the turnover of assets employed, the return on assets, growth; productivity of labor, control of inventory levels and control of debt levels; and you would conclude that all of those factors are important, together with many others. Some apply more strongly in manufacturing companies, while others are more important in service industries.

Yet over 90% of the variations of rate of return in all those companies, when measured consistently over three and a half years, could be traced to one single factor—the profit margin on sales. "No other single factor in our study had such a strong and consistent influence upon return on assets," reported Interfirm Comparison, the company that conducted the survey.

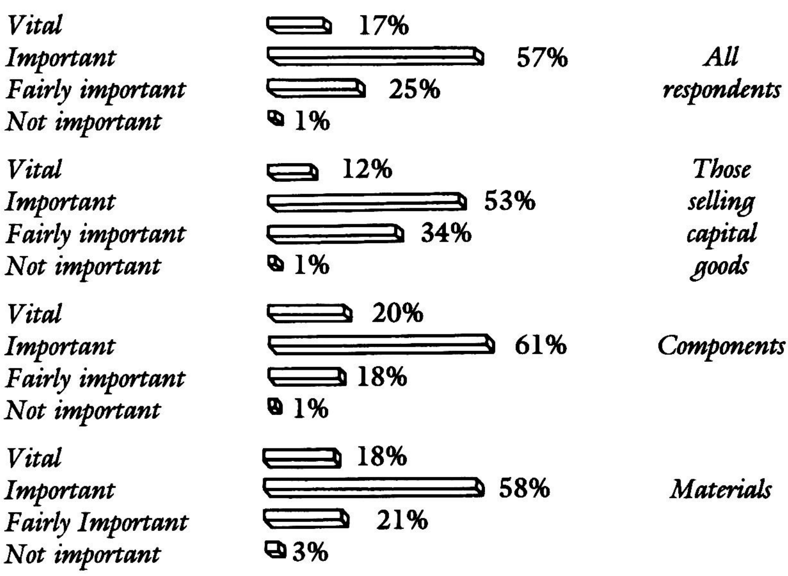
Companies place great emphasis upon their planning systems and control routines. Budgets, targets and policies are laid out for engineering, for production, for research and development. Marketing policy is debated in considerable detail. Finance, accounting and administration departments work according to their agreed plans. Purchasing, transport and distribution seek to improve their productivity. [All of those functions work efficiently because they each are handled by a specialist department with its specialist management.]

The management of pricing policy, however, is diffused at best and chaotic at worst in most companies. Very few companies have a Director of Pricing. As a result, pricing decisions are taken at different levels in the organization. Several departments contribute their point of view to the pricing decision. Management accounting, marketing, general management all want to be in-

Figure 2.1
Importance of price in overall marketing strategy

A consulting group carried out a study on how industry prices.* This study covered companies operating across a standard sample of industries, large companies and small.

We will quote results from this survey throughout this book. One basic question asked of all respondents was "How important to your company's marketing policy is your pricing strategy?" The table shows the answers.



Clearly, most companies in industry regard their pricing policy as being either vital or most important to their results. This is marginally more true of those supplying components to industry than those selling capital goods. Almost no company regards its pricing policy as being of no importance.

**How British Industry Prices,* Industrial Market Research, 1975.

volved in the process. Even the field salesman is often given the power to negotiate individual discounts with customers. The cumulative sum of the impact of all the decision-making influences upon the company's profit and growth performance is enormous.

Pricing policy needs special care and attention in a company, simply because so many different people influence it. The desire to head a company in the direction of all-out growth leads to a desire to knock down the price. The margins are tight, allowing little leeway for error. Any downturn in demand, however slight, can then be disastrous. At such a time, prices cannot be increased, so the pressure must be exerted upon costs. Services are stripped to the bone. The quality of the material deteriorates. The quality of the company's operation is reduced in every direction.

> Question for undischarged bankrupts: *Did you say you were going all out for sales volume at any price?*

A cut-price policy often leads to doom, as it did in the case of the Rolls Royce aircraft engine, unless the business is carefully controlled. The company went bankrupt after it tried to capitalize its research and development costs in order to shore up its profits, and was rescued by the government of the day. Cut-price automobile insurance was doomed—the business was poorly controlled and became a runaway monster. Certain travel agents were doomed when inflation in Spain drove up their costs after they had sold, and been paid for, vacations at cut prices. Now travel agents have surcharge clauses—particularly for fuel price increases or exchange rate fluctuations.

Some companies can do very well at cut prices, but they have to be razor efficient to do it; they must work their resources very hard; they hammer their overheads to the bone. For the price cutters, the line between success and failure is extremely thin. Supermarkets start making their net profits each week at 4:30 on a Saturday afternoon. Laker Airways could run a cut-price airline while it was very small, and while it had low overhead. While it was small, the large rivals did not copy it. But when Laker went after a major share of the transatlantic routes and was joined in doing so by another small rival, Air Florida, then the giants had to follow. Laker crashed. British Airways sustained huge losses and so did Pan Am. With very large fixed costs, and because of the recession in air travel and enough spare aircraft lying idle on the ground to equip Laker Airways completely, British Airways suffered from its policy of matching low cost operators from its corporate base of high fixed cost. Trying to sustain 18% of the intercontinental air travel market with the national flag carrier of a country with less than 2% of the world's population is courting disaster, if your pricing policy means that you must carry people to New York at a cost of 2¢ a mile! The chairman of BOAC, the original international part of British Airways, knew how to get his organization to make money regularly. He sold at sensible prices, and he always kept his management team at least one airplane short. So they made their existing planes work that little bit harder. That is how to make money.