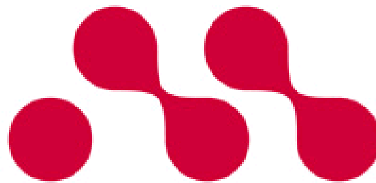

Improving your B2B Pricing and Profit

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"Pricing isn't simply about 'the price of a product', a good pricing approach considers both the buyers and sellers risk versus reward decisions.", argues Bryan Foss of Foss Initiatives. So what's required to improve your B2B pricing and profits?

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A buyer might consider a purchase to be higher risk if the price is relatively high in comparison to their expected benefits, or if payment is made in advance of the benefits occurring. Matching pricing and cash flows to expected benefit can help achieve buying decisions and competitive wins, but a good pricing approach must also deliver the seller profit required for a sustainable business.

If your pricing approaches aren't a good fit for your business-style you won't capture the rewards for the additional value you deliver to your customers. Instead you will struggle to compete with commodity and low cost suppliers on pricing, but with a higher cost skill base. Get pricing right and your customers will appreciate the flexibility to pay as they make staged implementation decisions and achieve staged benefits, while your company will gain the profits you deserve – perhaps you'll even 'earn as you sleep' as financial rewards continue to be harvested from your previous sales efforts.

If your company is developing new products and new types of sales propositions, you will also need to explore and implement new pricing methods to match. Many businesses are driven to do this as they move from product to solution selling or from in-country to multi-country sales. Not only is a new pricing policy required but also the retraining of sales staff to implement that policy with the customer, including the development of key account management, value selling and negotiation skills. As even the smallest companies often have large global clients to deal with, no company is excluded.

Before new pricing structures can be properly considered, the thought process might begin with the segmentation of key accounts and non key accounts (see the Kogan Page book 'Key Account Management in Financial Services' co-authored by Cheverton, Hughes, Foss & Stone). This is because pricing strategies can be developed to consider the value you can offer to your clients and how this is recognised (and might be rewarded) by them. To a great extent this will depend on whether you are operating in a commoditised or volume market versus having an accepted value proposition.

Good key account management

Good key account management becomes critical to future profitability within a wider business portfolio while the requirements and contributions of key and non-key accounts give valuable insights into viable pricing strategies for each. Buyer types can be identified, buyer-type needs explored and understood, this in turn provides opportunities for value selling of broader solutions to meet those needs (either alone or with alliances). Pricing structures are often developed to recognise the process of staged adoption within multi-country or global key accounts (whether centralised or decentralised), but this topic deserves a separate paper by itself.

Few businesses fully understand the profitability of their key accounts and other customer relationships, making a rigorous and precise selection difficult. While revenues can usually be tracked by customer, it often proves far more difficult to achieve a fair allocation of costs. Even those companies that can

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allocate the bulk of their costs by customer (e.g. professional services companies that log time sheets for billing purposes), still have a substantial proportion of overheads which are often allocated on an arbitrary basis, usually with little understanding of the true servicing costs of individuals clients. Despite this we know that some customers absorb far more indirect effort than others, and this reflects directly on the real profitability of those relationships.

Segmentation of customers

Once a segmentation of customers (by future profitability) is achieved, sales, service and other resources can be re-allocated. This approach aims to 'free up' resources from less productive markets and customers, allocating them instead to areas of best future profit. Understanding buyer types and their needs is essential, also developing the propositions (products, services and alliances) that meet those needs.

Value based pricing

This considers how much the client perceives as the value of the solution in their circumstances, for example if it allows them to retain valuable clients or drive into new markets it may be worth millions in benefit. However if they can buy the same solution from any number of suppliers then it becomes a commodity. Understanding the value and choices available to the client, and hence your importance as a valued supplier to them, enables pricing based on delivered and perceived value.

Early adopters

They might accept higher prices for preferential access to new solutions, enabling a competitive advantage for them, prices may then need to reduce as the solution becomes generally available and competitive advantage may lessen. Alternatively early adopters may be tough to persuade, so early prices may need to be discounted. As more proofs and case studies are prepared, prices may rise for later adopters. Which of these situations apply in your markets and clients and why? Can you use improved sales methods to gain sustain premium pricing with early and late adopters?

Risk and reward pricing

This is sometimes used to break through a decision blockage, for example where the benefits don't seem clear enough. If the supplier is convinced of the benefit they can be willing to take the payback risk themselves, perhaps funding part or all of the suppliers' part of project cost then taking a more substantial reward as project benefits occur. Suppliers who know their own capabilities for delivering ROI from specific project types can often make higher profits from risk / reward pricing than from simply selling the product or service to the client – if they are capable of agreeing favourable terms and customer dependencies up front.

While this sounds good in theory, it never proves as easy to implement in practice, for example it may be difficult to demonstrate that revenue increases resulted from this project, rather than from price increases or other effects. Clients also have considerable flexibility in the way they allocate revenues, costs and profits within a business, again making it difficult to ensure risk / reward contracts pay out. Overall, this is a great tool to have 'in the kit bag' but one which is more often used to break through client decision blockages, by comparison few risk / reward contracts are finally implemented.

Negotiation skills are key

Negotiation skills are key to the implementation of a good price strategy. Clearly the sales team need to understand the price structures to be used, but also the reasoning behind them and the way they need to be implemented with clients to maximise profits. Training in the application of in-house pricing structures becomes important, including the use of negotiation techniques. Where contracted prices are varied by negotiation, every attempt should be made to achieve something of value in return. For example an early-client might receive a discount in return for a decision-point press release, a public case study, hosting reference visits from prospective clients, speaking at sales events etc. Giving price reductions with nothing in return undermines the pricing structure and demonstrates that there is plenty of room for movement. In this situation a smart client will continue pushing until all that profit is gone!

Contracts may be priced to be profitable, but they must also be delivered with this in mind. For example if a project runs over time and budget, if a product is replaced, or of service support is far greater than expected, costs are

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higher than budgeted and profits can be significantly reduced. Having set an expected level of profit at contract time, it becomes important for the contract delivery to be managed in a way that retains that level of profit – while achieving an outstanding customer experience too!

Maintain cash flow

Cash flow is also important and this is associated with pricing for both the buyer and seller. In practice it is a total financial deal for the buyer and seller, where the client usually considers the total investment cash flow versus the cash flow of returns on investments. If the investment is made well before returns can be seen, for example through a large lump sum payment, this often makes the investment more difficult to justify. The investment could also be perceived to be a much higher risk for the client when payment is up-front.

For the supplier an initial cash flow can be very good news, as initial costs can be covered and financial risks are reduced. For example contracting for payment monthly in advance or requesting a percentage up-front rather than 30, 60 or 90 days later is as valuable as a price increase. Increasingly third party financing is used for large projects, enabling client payments to be scheduled as benefits occur, but paying the supplier up-front for products and services delivered.

Develop Strategies

They also need to be developed for handling price changes (increases and decreases), also the good management of price impacts on contract renewals and client retention, where packaged pricing is often renegotiated in some way. With all these thoughts in mind it becomes clear that pricing is increasingly a complex topic that affects many aspects of the supplier / buyer relationship – and most parts of the suppliers' business structure too. There is so much more that could be said on this topic, but we should leave some for later….

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This article complements
http://www.cimtech.org/newsletter/articles/06_feb/06_february_05.asp

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