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Weathering the Economic Downturn: Improving Your Realized Price

By taking a few simple steps, companies can pursue a low-risk approach to improve cash flow and earnings without adding to their overhead or headcount. The author, Navdeep S. Sodhi, is managing director of Six Sigma Pricing (www.iSixSigma-Pricing.com), a pricing consultancy based in Minneapolis and in London. He is co-author of the book, Six Sigma Pricing: Improving Pricing Operations to Improve Profits *(FT Press/Pearson, 2008). For more information Navdeep can be reached at: Navdeep@iSixSigmaPricing.com. This article was originally published in* MinnesotaBusiness *(February 2009).*

A few years ago, in much better economic times, a multi-billion dollar firm found that it was losing $60 million of pure profit by failing to enforce pricing terms in customer contracts. You would think that in an economic crisis, companies would do anything to protect earnings, but in reality it is quite the opposite. Even now, when financial health has never been more critical, companies continue to leak cash due to uncontrolled discounting in hundreds of transactions. However, excessive discounts (intended or not) may increase unit sales but still result in a loss in revenue and profit. It is time to take a closer look at your pricing strategy, your internal pricing methods and the prices actually being realized by your company.

There is a common misperception that the price of a product or service can be derived by simple math. Obviously, the net price to customer is derived from a list price or MSRP after factoring in discounts, concessions, or rebates and other contract terms. **But it takes many processes to realize this net price from customers. And these processes become complex when the various people involved in pricing have diverging incentives and objectives. Even if the strategy is sound for a given set of customers and competitors, internal processes for modifying list and for controlling discounts may be broken.** While pricing strategy gets attention in board rooms, senior managers spend surprisingly little time in overseeing execution. And when a sound strategy fails due to poor execution, it feeds the general—and erroneous—perception that protecting price is more difficult than downsizing and other painful cost cuts.

Executives looking for a low-risk approach to improving earnings and cash flows should:

1. **Articulate Justification of Price Actions to Internal and External Stakeholders.** Consider B2B markets, where purchase managers accepting price increases from vendors have to justify such decisions to superiors. Sales reps also balk unless they can clearly explain and justify price increases. Focused training can help frontline personnel to communicate consistently with customers and comply with internal guidelines effectively.
2. **Map Pricing Processes to Understand Bottlenecks.** Understanding how price-related information flows amidst the company's people, processes and IT systems helps organizations to identify and prioritize issues for resolution. For example, pricing people may be side-stepping analysis and due diligence because of constant pressure from sales reps to make quick decisions. Transparency in internal processes, standardized analysis, and documented policies help protect price and speed up approval decisions.
3. **Align Objectives and Incentives in the Near Term.** Define roles and accountability for various people involved in pricing execution, so they pull in the same direction. **Aligning functional objectives using compensation is ideal, but that can be quite difficult and gets entangled in company politics. Instead, managers should specify common goals across functions in line with the scope of pricing projects. This helps build the "burning platform" and keeps people from blaming each other.** Otherwise, why would sales reps earning commission based on volume follow directions from a pricing manager interested only in margin?
4. **Track and Measure Success of Price Actions.** Senior executives should monitor execution by reviewing sales results and carefully considering feedback from frontline teams. Regular cross-functional meetings are useful in tweaking actions for greater effectiveness. For example, they can help in deciding what to do with customers who are unwilling to comply with contract terms.

All these actions are possible within the scope of jobs held by existing employees. Companies with Lean or Six Sigma expertise should instill a quality focus in pricing processes. Others with limited resources should also evaluate their internal pricing processes for basic quality.

When the right steps are taken, the benefits can be significant and show up almost immediately. A manufacturing company gained $10 million in one division alone after a cross-functional team helped tighten the pricing process within 10 weeks. A tooling manufacturer gained $40 million from a price increase by improving internal controls and training sales personnel. Both companies improved their ability to realize price without losing market share.