UPFRONT

PRICING STRATEGY BY D. DOUGLAS GRAHAM

Why higher prices can bring higher profits

Should a distributorship raise its prices in a marketplace inhabited by carnivorous competitors and super-savvy buyers? Pricing experts claim that it's imperative to do so.

In today's dynamic marketplace, establishing price management systems can help distributors remain profitable—and allow them to keep pace with the market.

Distributors must learn to live with thin margins. According to pricing experts, the average distributor's take-home pay equals a net profit of only 2% to 4%. That translates to approximately $.04 for every $1 generated in sales revenue—extremely slim pickings when the costs of inventory management and all other necessary business expenses are factored into the equation.

Theoretically, distributors compensate for starvation wages with volume, but does this hypothesis compute in reality? Sure, if the price is right—and therein lies the rub. Pricing is trickier for everyone in business today—from electrical distributors to tree surgeons.

Competition is brutal and getting more so all the time. Customers have been cashing in on this situation for a couple of decades, and have grown accustomed to getting the best bang for their buck. Thanks to the Internet-empowered global economy, commercial adversaries can now compete with one another from across town or across the sea. Many distributors see higher prices and less business as mutually inclusive concepts, a scary thought to be sure. However, the opposite scenario is equally fearsome. Lower profits kill growth, and ultimately that may mean no business at all.

"There's no more important number than the one on your price tag, and nothing provokes a case of the cold sweats like the thought of raising it," Alison Stein Wellner pointed out in the June issue of *Inc. Magazine*. "After years of almost no inflation, relentless downward pressure from places like India and China on the price of almost everything, and comparison shopping at the click of a mouse, it's more competitive than ever out there. It's easy to see why fewer than one-third of business owners surveyed by the National Federation of Independent Businesses reported in February that they had increased their sales over the past three months."

Killer deals

Margin is grown or lost through pricing practices, according to Erik Bleyl, president and CEO of Advanous, a provider of tools for margin improvement based in Richmond, Va. "Too often, fear of losing customers or of potentially overcharging them discourages a rep from high-margin pricing," he said. "Even the most effective salespeople sometimes feel guilty about making a profit, and that's ironic given the fact that most derive a significant portion of their income from commissions."

Salespeople play a crucial role in corporate profit making, and the ramifications of their behavior are both good and bad for distributors. Many companies grant their reps generous pricing latitude. The best of the breed consistently earn high gross margins for their employers and keep their customers happy at the same time.

Other reps find this balancing act very tough to pull off. They fall off the tightrope because of pressure from marketplace pricing competition and customer demands for sweetheart deals. This scenario is all too common in distribution, and is certainly the foundation for most margin degradation issues. Some reps maintain entire lists of customers to whom they peddle their wares without profit because the cost of customer service in each case exceeds the gross margin dollars generated by the business.

"Common wisdom has it that the mission of salespeople is to sell as much product as possible," noted Bleyl. "But that's not the whole story. Even more important than a rep's ability to push product is his or her aptitude for performing the magic required to earn profits, and to do that the salesperson must consistently sell at a price that makes money.

"While this practice is rooted in common sense, it's not all that commonly practiced. Salespeople are paid to sell and many will do whatever they can get away with to get the job done," Bleyl continued. "A company can get a grip on the problem by closely managing its sales force, but it shouldn't stop there; distributors should also adopt pricing strategies and routines aimed at generating more margin dollars."

Leaving money on the table

Through the use of technology, Advanous examines massive amounts of data, identifies lost margin opportunities, and provides actionable recommendations for improving a company's bottom line. This is but one path on the road to price-assisted profitability. There are two purely tactical methods for managing prices. The first is an indirect approach that includes a series of administrative strategies that allow a company to grab low-hanging fruit and thus improve revenues. These strategies include:

• Tightening payment terms. When it comes to profits, time and money are synonymous concepts because dollar value diminishes over time. Many distributors leave their profits on the table by providing customers with easy credit terms, such as skip-billing and extended payment arrangements up to 180 days or more. Pulling in the reigns on this sort of thing will probably annoy some customers, but it will also enhance profitability by bringing the money in faster.

• Questioning minimum order requirements. Small orders are often profit-challenged because the administrative and warehousing costs required to get them out the door just don't add up. Then there's the corollary of free shipping. Shipping can run a good chunk of change even for destinations a town or two away. Reevaluate the distributorship's freight-free policy and adjust it if necessary.

• Disallowing unearned discounts. Some customers automatically take prompt payment discounts even when markdowns are not justified. Distributors often turn a blind eye to the peril of profit, but shaving unearned discounts will help increase profits.

Although "there are scads of ways to keep on top of pricing," according to Rob Schreibman, senior vice president of the National Association of Wholesalers, distributors can also utilize a more direct approach to manage prices. "Enterprise Resource Planning Systems, for example, typically have pricing sequences. There are also many books available on the subject of pricing, and networking with colleagues can be very helpful in this area as well. First and foremost, though, pricing policy should remain the purview of top management. Under no circumstances should it be deferred to the sales force. Companies sometimes lose sight of this simple and very sensible rule, and in the long run it really hurts them."

Professional Pricing Society President Eric Mitchell explained that a program of direct pricing management should principally entail the careful and regular scrutiny of product costs. Suppliers sometimes raise prices unexpectedly—something a distributor should watch and compensate for by bringing its prices up to speed.

"Many distributors are hit with price hikes all the time but only change their prices on a semiannual basis," Mitchell noted. "That's a senselessly expensive oversight. In today's world suppliers are frequently hit with commodity price hikes, and eventually those cost increases are sent down the supply chain to their customers.

"If a distributor does not look closely at its supplier cost pass-through, it is probably absorbing the price increases already," he added. ■■■

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