



# PURCHASING HARDBALL, PLAYING PRICE

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Ask yourself this question: “Are my company’s selling processes keeping pace with the level of investment and sophistication that our customers are making in their procurement process?” If you are like most managers, the answer is “No.” Still further, if sales in your industry are characterized by profit-sapping negotiations between you, your customers, and your competitors, the keys to capturing those lost profits are found in this article.

For suppliers operating in industries characterized by tough competition and costly negotiation, the best offensive strategy to even up the odds with customers and competitors is to: (1) set your prices based on the unique value that is delivered to the customer through your products and services, and (2) negotiate value delivery instead of price.

As the frontline of your organization, account managers and sales reps must communicate the value your company delivers to the customer as a justification of your pricing. However, customers will work against you by raising many challenges to your company’s value message. Arming the account managers and sales reps to manage this situation is the required defense to capture a fair portion of the value you deliver.

Best-practice solutions for value communication and value-based negotiation require a coordinated effort between account

management and sales to develop the tools and organizational capabilities that will communicate and defend your value message and capture a fair price.

## It’s a Game

Selling has evolved to a negotiation game in which each side plays a role but doesn’t always play by the same rules. Take, for instance, the experience of Bob, a general manager and sales executive for an information service provider who, on his first big deal, learned a valuable lesson. When Bob was a young sales rep, his manager couldn’t attend the final client meeting because of a family emergency. Bob’s orders were to “close the deal but don’t lower the price.” When the client wouldn’t back off on the price, Bob apologized and headed for the door. Before he could leave, the client signed the contract. Bob learned then that negotiation is a high-stakes game in which positions are seldom “final.”

Stakes in sales negotiation are high because of the leverage price has on profitability. A 5 percent improvement in price can have a positive impact of 50 percent on profitability, given the cost structure of the product or service (see **Figure 1**).

**Figure 1**  
**Leverage effect of price on profitability**

		<i>Action</i>	<i>Impact on profit</i>
Price	\$100	Reduce VC by 5%	7.5%
Variable cost	\$15	Reduce FC by 5%	37.5%
Fixed cost	\$75	Improve price by 5%	50.0%
Profit	\$10		

Recognizing sales negotiation as a game is critical to success. It is possible to play the game like a pro, but many account managers behave more like amateurs. The moment they demonstrate a willingness to lower price because of the buyer's negotiation tactics, they send the signal to the customer that price is "in play." The danger for a seller in negotiation is granting a discount, or lowering price, without an objective justification for it. Such an action communicates that the seller's pricing lacks integrity and that the door is open for the customer to launch an all-out assault, driving prices down.

Once the discount door is opened, the negotiation game focuses on identifying the price the buyer is "willing to pay." The critical issue to understand here is that willingness-to-pay is based on the buyer's perception of value and negotiating stance. Therefore, the focus of the seller should be on managing that perception, forcing the buyer to acknowledge value delivery and thereby countering any aggressive negotiating games. The key to success is to maintain the connection between a customer's willingness to pay and the value he receives. When prices are based on the impact on the customer's business, the integrity problem is solved and the seller's job is to shape the buyer's perception and communicate the unique value the offering has for the buyer's business.

**What Does Communicating Value Mean?**

To communicate value, a seller must first understand what it means to the buyer. As economic impact, "value" is the dollar amount of how to help the buyer earn more revenue or reduce costs as a result of using the seller's product or service.

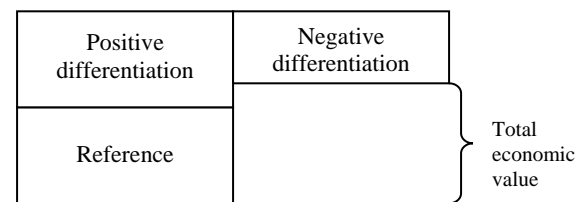
A framework for understanding and communicating the unique value of the offering in economic terms is Economic Value Estimation, or EVE® (see **Figure 2**). EVE® starts from the customer's perspective and compares the seller's offering versus a "next-best" alternative. This alternative

establishes the *reference*. A competitor's offering or an in-house solution are common references used in EVE®. The customer's dollar outlay for the reference establishes its "value."

With the reference as the foundation, the EVE® framework identifies the positive impact the seller can deliver compared to the competitive alternative. This is called *positive differentiation*. Differentiation value is depicted as the economic impact the unique elements of the offering have for the customer's business.

*Negative differentiation* must also be assessed relative to the reference. This is important because the customer will most likely be aware of areas in which the supplier's offering is inferior to a competitive alternative. Failing to recognize the negative differentiation raises the risk of undermining the objectivity of the comparison. The economic impact of the negative differentiation is subtracted from that of the positive differentiation. The net differentiation is then added to the reference value, which sums to the total economic value of the offering.

**Figure 2**  
**Economic Value Estimation®**



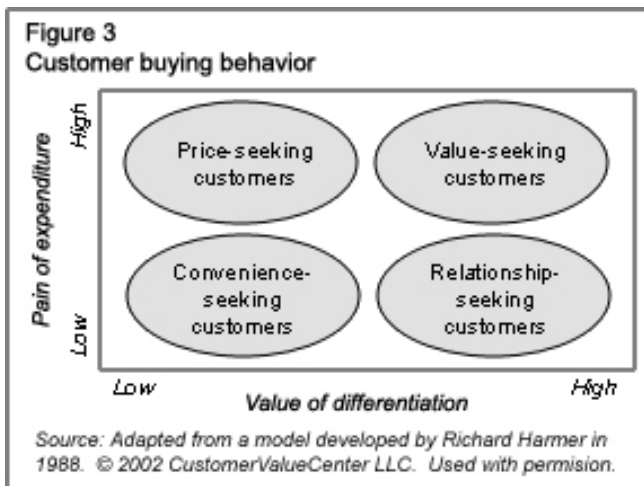
Developing EVE® with information from customers operating with the same business model establishes a basis for pricing across a segment, which provides price consistency for similar customers. Unlike suppliers, customers are not prohibited from sharing price information. They lose trust in suppliers that use inconsistent pricing, and they negotiate more intensely to protect themselves.

EVE® is shared with buyers to set their expectation on the value of the offering and

justify the price. By demonstrating the value you deliver, you are letting customers know that you have an interest in helping them with their business and that you know your value delivery. But not all customers will be interested in having a conversation with you about value; identifying the right ones is important for being successful.

### Customer Buying Behavior

Customer buying behavior can be described using two categories, as shown in **Figure 3**: (1) the degree to which the customer sees and recognizes differences among suppliers, and (2) the degree to which the customer organization experiences “pain” in parting with money. For price-seeking customers (upper left quadrant), everything is a commodity and price is the *only* factor that matters. These customers are not good targets for a value-based message. Because they represent no more than 20-30 percent of industrial markets, the best strategy for



Selling to them is to give them a no-frills offer at a no-frills price, thus reserving scarce sales resources to pursue customer targets with high profit potential.

Convenience-seeking customers (lower left quadrant) see no differences among suppliers but hurt less when spending money. Often, these firms have been caught short by a spike in demand or an unusual situation, so they need a solution and they need it fast. Such customers typically make up less than 10 percent of industrial markets.

On the other side of the matrix are the customers that recognize meaningful differences among suppliers and are the appropriate targets for a value-based message. Relationship-seeking customers (lower right quadrant) understand and appreciate the differences your company provides. They like what you have delivered in the past and they want more of the same. This is not to say that price is not an issue for them; relationship-seekers do not want to be taken for granted, but price is not a major consideration. The key with these customers is to never undermine their trust.

The value-seeking segment (upper right quadrant) is the prime target. These customers recognize differences but do not like to spend money. They weigh every decision based on what they pay versus what they get. They will make you work hard to communicate your value in the selling process as they evaluate what you are offering.

A key to successful negotiations is recognizing that many value-seekers disguise themselves as price-seekers – a fact that contributes heavily to the perception that price-seekers make up the majority of the marketplace. These buyers have learned that by strongly communicating price as the only important factor in their decision, they can win deeper discounts. The savvy sales rep listens for clues about customer needs outside price and employs techniques to pare back differentiated elements of the offer to expose the real price-seekers from the actors. When confronted with the prospect of a commoditized offer, the value-seekers unmask and reveal their true needs.

### Subtraction Techniques and Structured Trade-offs

Price-destroying sales negotiations focus on identifying the price the customer is willing to pay. Sellers playing this game negotiate price discounts on their offering. Because the offer is “fixed,” or constant, whereas price is lowered, this game is called a *fixed offer/flexible price* strategy. The strategy is played out by the sales force across the customer base, so the seller’s realized prices are highly variable. This variability

constitutes discounting without a justifiable economic rationale.

The practice of ad hoc discounting destroys price integrity and customers' trust in the seller. Discounting in itself is not bad, but discounting without an offsetting reduction in value empowers customers to demand even more discounts and hurts profitability. Providing sales reps with the flexibility to negotiate the offer, *not* the price, is the first step toward moving away from unstructured discounting.

If customers want a lower price, they must accept a lower level of value. Known as a *flexible offer/fixed price* strategy, this is accomplished by employing subtraction techniques and providing customers with structured trade-offs of value and price. Lowering value is the result of eliminating product features, supplemental services, or terms that create unique value. Dell computer uses this approach for sales over its website. Customers can select a range of computer features, but the price for each is fixed.

Deploying a flexible offer/fixed price strategy requires developing a menu of offers based on the following techniques:

- *Versioning* – features of the offer are deselected or “ghosted” to reduce functionality and value; frequently used in high tech applications such as software, versioning allows for achieving economies of scale in development/manufacturing while still providing multiple value levels
- *Bundling* – packages of complementary products and/or services with different levels of functionality are put together
- *Flanking products* – sales reps gain negotiating flexibility by creating a portfolio of products; higher- and lower-value products help unmask value buyers masquerading as price buyers

Marketing and account management's task is designing the packages and flexible options as well as the communication

messages for the sales force to use with customers.

Adopting a flexible offer/fixed price strategy provides account managers and sales reps with an effective counter to customer price pressures. Customers benefit as a result of having options that allow them to select the package that best matches price with value. Suppliers benefit by capturing higher returns as a result of reduced discounting and stronger relationships with customers stemming from better price integrity.

### **Where the Rubber Meets the Road**

Pricing and account strategy are put to the ultimate test in the field when account teams negotiate with customers. While a value-based selling strategy is a prerequisite to a successful negotiation game, preparation is essential. The key to realizing a return on your strategy hinges on a sales force that is prepared to handle customer pushback on the offer and price. The value-based tools outlined in **Figure 4** are highly effective for managing customer value perception and countering price pressure. To complete the rep's tool kit, the final component for successful negotiations is planning. Anticipating when and how customers will push back is important for helping an account team plan its responses.

At a high level, the basic strategy employed by savvy negotiators against a value-based strategy is to undermine the integrity of the price structure. They will work at this by (1) disassociating the offer from the appropriate price and (2) preventing the rep from successfully communicating the value of the offer. Buyers will use both tactics in conjunction at varying points of the negotiation and may opt to energize the negotiation emotionally. To succeed, reps must recognize these arguments for what they are and be ready to counter with a value-based response that allows them to properly frame the negotiation on the value delivered and preserve the integrity of the pricing.

**Figure 4**  
**Tools for handling aggressive bargaining techniques**

<i>Aggressive bargaining technique</i>	<i>Value-based response</i>
Early request for price quote	Probe buyer's needs. Quote list pricing or a w-i-d-e range.
Focus on seller's cost and profit margins	Communicate ways you lower costs for the buyer through unique elements of your offering.
Constrained by buyer's budget	Identify items that can either be trimmed from the proposal or shared with other budget centers.
Provide a discount to win future business	Explain your perspective that future business is based on value delivery today.
Price discounts based on past service failure	Seek to understand the issue and its impact, then fix it without providing a price discount.
Requests for additional items at no charge	Explain the offering menu and that items purchased outside the scope of the agreement are priced "à la carte."

### Starting Off on the Wrong Foot

In the early stages of negotiation, value-seeking buyers will request a "ballpark" price quote, often before all the specific details of their situation are known to the rep. Their intent is to anchor the negotiation on a low price. Their next move is to raise the value of the offer while maintaining the anchor price. The "value-enlightened" rep recognizes the dangers of responding to the early request and either provides a w-i-d-e price range or uses the request as an entrée to dig in for the details of the buyer's specifications.

### Manage Costs

In the heat of the negotiation game, the buyer may employ a variety of cost-based arguments as leverage for lower prices. These tactics focus on how much profit the supplier is making on the deal. Buyers will inquire about the supplier's costs or margins. The value-savvy account manager or rep will take this opportunity to reframe the cost discussion to be about ways the supplier helps to lower the *buyer's* costs through elements of the offer that are unique to the supplier.

### All Too Common

A common scenario is when the buyer tells the rep, "I love the offer but the problem is your price is higher than my budget." With the budget as a constraint, the buyer is looking for a discount. The rep recognizes this is an important time to repeat the company's official discount policy but looks

for ways to either trim items from the buyer's wish list or help the buyer identify other budget centers that benefit from the supplier's unique value. These sources of funding may likely expand the buyer's budget.

### Good Cop, Bad Cop

Some buyers may energize the negotiation emotionally. Strong feelings ranging between friendship and outrage are presented as the basis for a better deal. A common friendly scenario is a promise of future business if the discount is increased for this one-time deal. The value-seasoned rep knows to frame the importance of the relationship with the buyer on the economic value delivered and focus the conversation on the current business knowing that any future business lies in communicating and maintaining the differential value of the offer.

Outrage over past failures is another common scenario. The rep is viewed as responsible for past product or service failures. The prospect of future business is predicated on a deep discount to make up for those problems. In response, the rep should inquire about the nature of the failure in order to present relevant details to those who will correct the issue. The rep should also inquire about the value lost by the customer organization as a result. Once identified, the rep should move to correct the problem without using discounts as a fix-all. In these situations, it is far better to offer a significant guarantee that the problem will not occur again than to offer even a small price concession. In the event the problem recurs, the price concession would not retain the customer's business. However, if the glitch is solved, the price concession establishes a costly discount on all future purchases. If the problem is fundamental to the offering and not easily addressed, the supplier may need to revisit the pricing decision based on the value that is actually delivered.

### Freebies

Another common tactic for buyers is to settle on an offer but follow up with pressure on the rep for extra items at no charge. The

rep, in response, must fall back to the menu of structured trade-offs and explain that the items the buyer is requesting are part of a different package that has a higher price. Items purchased à la carte are priced at a premium to encourage customers to purchase from the menu of packages. (Note: The rep must have communicated this up front with the buyer; failure to do so risks alienating customers.)

### **Summary**

Sales negotiations are a game that can either destroy or build value. Price negotiations destroy value; offering negotiations build value. Managing buyers' perceptions of value is necessary for properly establishing your price in a negotiation and a key to improved profitability. Developing a flexible offer/price menu is an important tool for reps to counter price pressure from buyers and maintain price integrity. Preparing account managers and sellers to anticipate and respond to the tactics savvy buyers use in negotiation is required to keep pace with the growing sophistication of aggressive purchasing practices.

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