The Value of Pricing Discipline

A Vantage Partners Sales Study on the Impact of Pricing Exceptions

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Contents

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In our Sales Advisory practice we frequently see clients run into difficulties in negotiations with customers due to a history of having made frequent pricing exceptions off their list or "standard" price. By "pricing exception," we mean making a decision to deviate from list price or standard price for some reason, be it a volume discount (not built into standard pricing) in exchange for making a commitment of a certain length, or perhaps just because the customer demanded a discount or made a threat to extract a price concession. Many companies have trained their customers to expect such discounting as a matter of course — if a supplier ever refuses the pricing exception, or tries to hold the line, the customer counters by threatening to go to the competition, and *then* the supplier caves and gives the price concession — rewarding their toughest, nastiest customers with the best pricing. Sales managers have a large and understandable fear of losing customers, especially those they have had for a long time and had to fight hard to win in the first place. The easier choice often seems to be to grant the exception and land the deal, keep the customer for another contract cycle, and hope to hold the line better next time. But, do these exceptions truly only impact the negotiation at hand and short term margins, or do the ramifications go far deeper?

This study was designed to gain an understanding of the depth and prevalence of pricing exceptions and how companies manage them. The study then explores what drives companies to grant pricing exceptions and begins measuring the implications of granting exceptions on the future negotiations and interactions with both individual customers and the market as a whole. Perhaps most importantly, the study begins to examine what happens to the companies that say "no."

For many readers, this study may raise questions about your own business practices and some fundamental concerns about your corporate approach to pricing and customer negotiations. At Vantage, we are always interested in hearing reactions to our studies and in helping organizations better understand the implications of pricing exceptions in their unique environment. Please contact us to discuss these findings and possible strategies for breaking the pricing exception cycle in your organization.

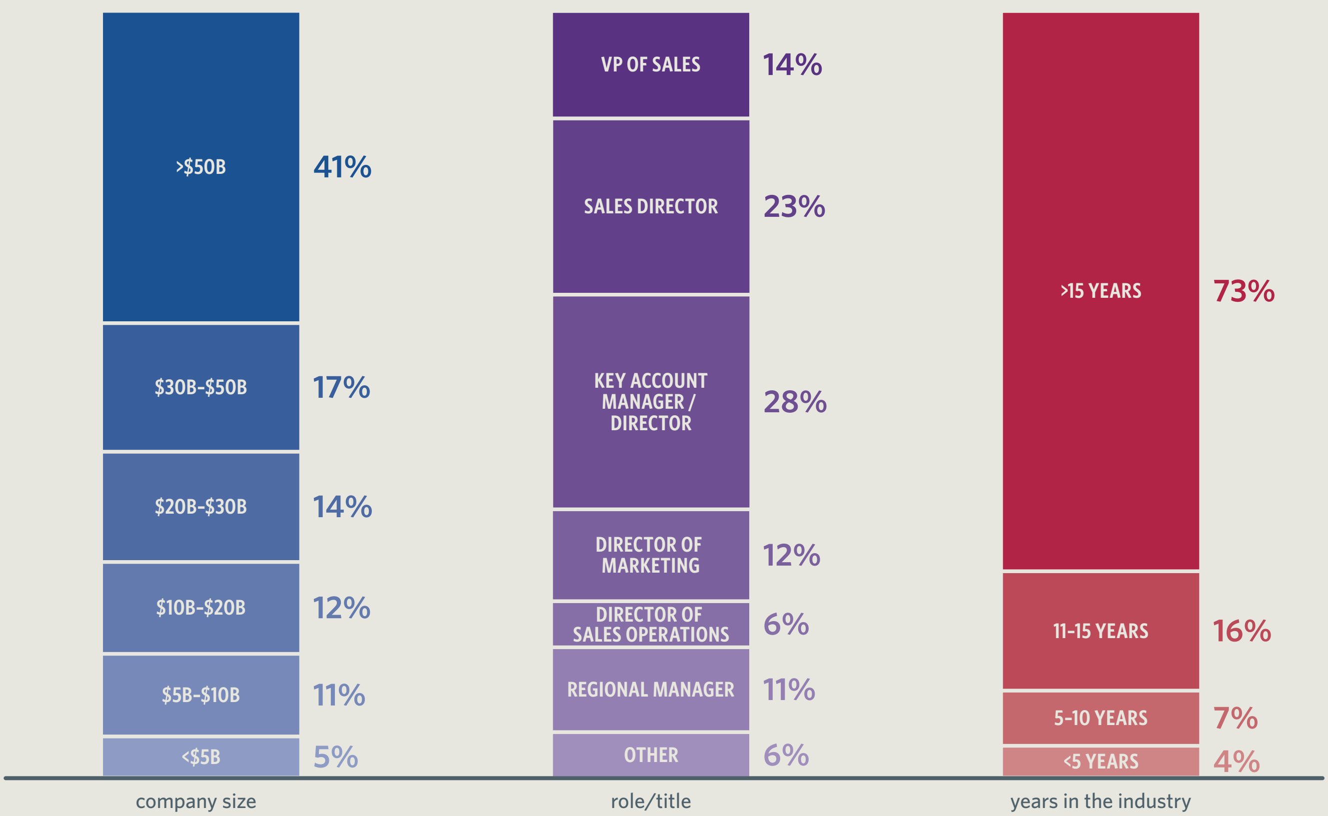
Study Summary

- Companies that grant pricing exceptions with the greatest frequency experience more rapid ASP decline
- While certain circumstances lend themselves to making pricing adjustments (e.g., large volume order, long term contract), often exceptions are made for reasons that are ad hoc and less defensible, and may set unintended market precedents or incent tough tactics by customers (e.g., unsubstantiated fear of losing a customer to a competitor, caving in to threats)
- Rapid short and long-term ASP decline is especially prevalent in companies that more frequently grant ad hoc exceptions
- Many companies do not seem to track or be aware of the possible effects of pricing exceptions on their overall selling price
- The reasons why one might choose to make a pricing exception (e.g., to retain customers, speed up the negotiation, or increase customer satisfaction) often fail to achieve their intended results
- Despite the benefits, rolling out improved pricing discipline requires careful thought and caution to avoid significant disruption in current accounts. Prices must be set at a level that is fair and defensible by the sales team, commensurate with the value the customer receives, and within the market, and salespeople should have the flexibility to develop creative solutions that meet both sides' interests (e.g., a lower price for a longer term commitment)
- Companies that are truly best in class at managing pricing exceptions share some common attributes: a clearly understood process for determining when and why pricing exceptions are granted; salespeople who are able to define and defend the value of their product to customers (and well-supported by their organization in doing so); a system to track exceptions and adjustments as they are made; and metrics and incentives that are structured to enable salespeople to walk away from "bad deals"

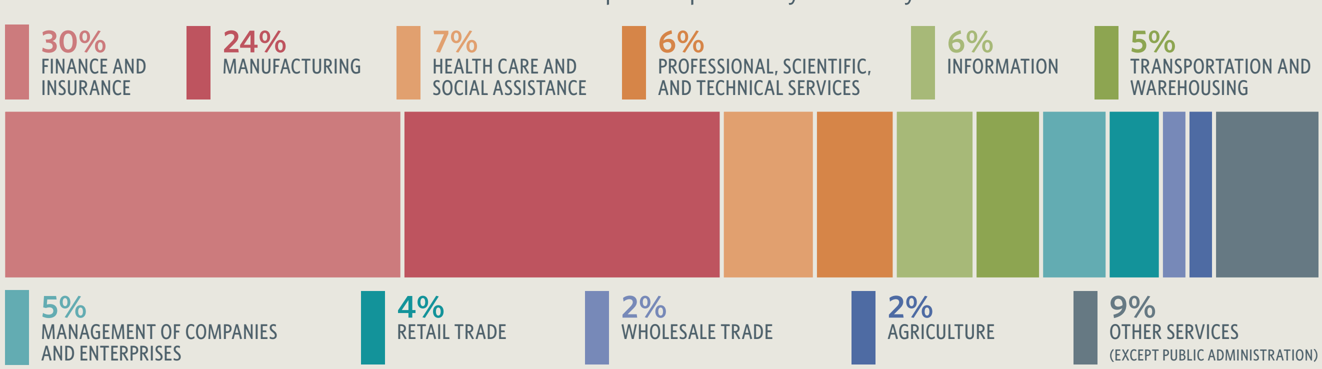
Demographics

For this study, Vantage targeted senior sales executives of large Fortune 500 organizations across industries, in order to have a population of respondents likely to be in negotiations with customers with the ability to approve or deny exceptions. 83 sales leaders (managers and above) responded, and over 80 companies in 11 industries were represented.

Summary of demographic information



Distribution of participants by industry



Illustrative participating companies

Allstate Insurance
American Express
Ametek
Aramark
Arthur J Gallagher and Co
AT&T
Bed Bath & Beyond
BMO Harris Bank
Boeing
Cargill
Chase
Cisco Systems
Citi
Coca-Cola
CSC
Dignity Health
DZ Bank
Emdeon
Experis
GE Capital
Genworth
General Motors
Haworth
Health Net
ING Capital
John Hancock
Kohl's
Lockheed Martin
Microsoft
Morgan Stanley
NAPA
Nestle Waters
Oracle
Orange Business Services
Panasonic
Pfizer
QBE
Raytheon
Resources Global Professionals
Ricoh
Sanofi
SAP
Sears Holdings
Southern Wine and Spirits
TD Bank Group
Thomson Reuters
UBS
Ultra Electronics
Unisys Corporation
Walgreens
Waste Management
Wells Fargo

Study Results

Given the size and rate with which suppliers tend to grant exceptions, it is no wonder that customers ask for them.

Frequency, Size, and Impact on ASP

Companies surveyed grant exceptions to their list price as a matter of course. Nearly 60% of companies indicated that they grant exceptions at least half of the time and a full quarter of companies almost always grant exceptions (75–100% of the time) (see Figure 1). These exceptions are of a significant size; nearly half of the companies granted pricing exceptions in the range of 10–24% off of their list or "standard" market price (see Figure 2). Considering the size of these companies and their average deal size, these exceptions are not only frequent, but also substantial — with a weighted average of nearly 13% off of the list or standard price.

Given the size and rate with which suppliers tend to grant exceptions, it is no wonder that customers ask for them. To play the game, many companies that grant exceptions undoubtedly build the cost of their exception into their list price, giving them the wiggle room to concede on price and make the customer happy. That said, setting a precedent of conceding to a request for a discount makes it more difficult to stand firm when it is necessary to hold the line on price, and makes customers wonder just how low their suppliers can go — incenting them to negotiate harder and harder for every last dollar. Moreover, as suppliers are on the slippery slope of ever-increasing discounts, clients are less and less happy with whatever discounts they receive because no matter how large a discount they receive, they may wonder if they should have pushed for more.

Just one exception can quickly become a new market standard — made even more likely with the ever-advancing sophistication of procurement organizations and increasing pricing transparency.

The study data also indicate that granting exceptions can drive long-term pricing impacts that may be greater than companies anticipate. While 44% of companies surveyed indicated that they were spared from decreases in average contracted pricing, just as many, 45%, indicated that they saw a drop in average negotiated pricing for all customers to newly excepted levels in **less than one year** (see Figure 3). This indicates that for many companies, granting pricing concessions may be a significant contributor to driving down average selling prices (ASPs).

As salespeople are considering making a pricing exception for a single customer, the ultimate market consequences of that decision may be underappreciated. If the customer is threatening to walk if a concession is not granted, the true cost of losing that customer should be considered alongside the costs of setting a market precedent that could drive overall pricing downward. "Just one exception" can quickly become a new market standard — made even more likely

How often are items sold to customers at any price other than list (or standard) price?

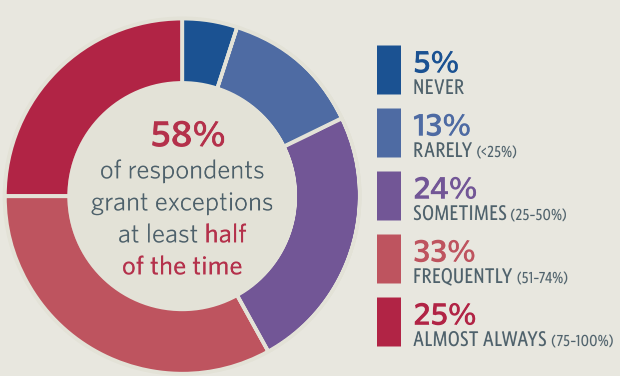


FIGURE 1

When an exception is made, what is the average amount of pricing exception given?

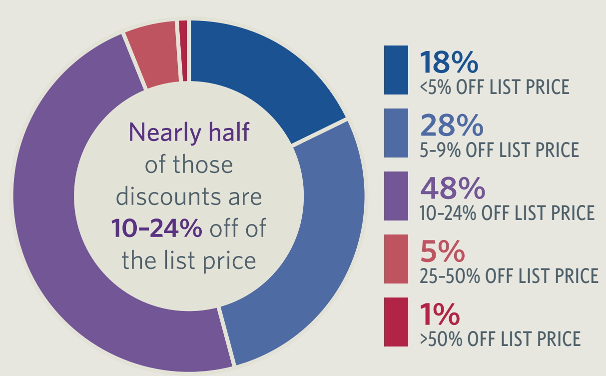


FIGURE 2

with the ever-advancing sophistication of procurement organizations and increasing transparency of pricing. Realizing the impact exceptions can have reinforces the importance of pricing exception policies and processes to ensure they are made in a consistent manner. Instead of exceptions, pricing "adjustments" that are systemically considered and made for commercially justifiable reasons (e.g. changes in scope, different volumes, different services or levels of service) should be built into the pricing schedule. This will ensure consistency of pricing across like customers for like services and defensibility in negotiations, as well as enhance the ability of sales teams to explain why the price is what it is. In setting such a pricing discipline regimen it is important to understand why exceptions are being made in the first place and what the effects of giving them are on the business.

Once a pricing exception has been made, how quickly do average negotiated prices for all customers tend to drop to the newly excepted level?

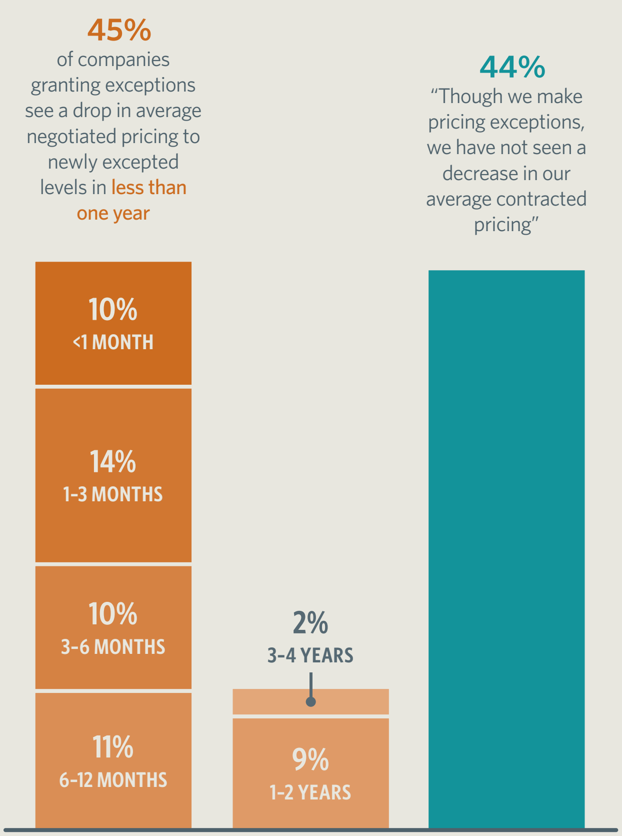


FIGURE 3

Commercially justifiable standard pricing adjustments — incenting good customer behavior

- That which makes it less expensive to deliver goods or services at lower cost, and therefore allows passing some savings on to customer (e.g., volume discount, flexible delivery time, junior staffing mix or looser SLAs)
- That which gives more value to the seller from other sources (e.g., minimum volume/purchase commitment, "wallet share" commitment, serving as reference account, larger order/batch sizes, longer delivery cycles, future price increases built in, longer contract term)
- Due to the nature of the customer or the type of sale (e.g., government pricing, 501(c)(3) pricing, pro bono work)
- Simply providing less value to the customer (e.g., fewer features, smaller scope, package without service or less extensive warranty, or risk shifting to customer — no indemnification from seller)

Ad hoc pricing exceptions — rewarding bad customer behavior

- Threat by customer to go to competitor
- Escalation to more senior person
- Abusive treatment, emotional outbursts, or yelling
- Customer demanding a discount or accommodation "for the relationship"
- Withholding orders to create end of quarter or end of year sales pressure
- Demanding we match a price given to another customer (of which this customer has become aware)
- Demanding we match a price quoted by another (perhaps less qualified) potential supplier

Why Companies Make Exceptions

To explore why companies choose to make pricing exceptions in the first place, sales leaders were asked to indicate how often they made pricing exceptions for a variety of different reasons (see Figure 4). These different types of exceptions were bucketed into what we labeled "systemic" price adjustments, which were granted for justifiable reasons (for example, a large volume or revenue order, in exchange for making a long-term commitment, or to match local geographic pricing) or "ad hoc" exceptions, which were made for less justifiable reasons (for example, out of fear of losing the client — whether or not an overt threat was made).

Though pricing exceptions may be necessary at times over the course of doing business, "ad hoc" reasons accounted for two of the top five reasons exceptions were granted. The top reason for granting exceptions, to match competitor pricing, can be either ad hoc or systemic, depending on the situation. Making concessions for the two "systemic" reasons in the top five, due to size of order or length of contract, are generally more defensible and justifiable than the other ad hoc reasons. Exchanging longer-term commitments or making a higher volume purchase for price concessions are sometimes useful tradeoffs to bridge a gap if the customer is concerned about price. Though each situation should be considered on its merits, ad hoc reasons for making pricing exceptions are more worrisome, and can create traps with customers that are hard to break free of in negotiations down the road. In particular, unlike systemic pricing exceptions, they actually incent customer and client behavior that suppliers would prefer not to see — and effectively give the best pricing to your worst customers!

"One astute thing our company has done is really stick to our pricing grid. With $10M in purchasing volume it's a 3.0% discount, then 3.25% for $20M, then $30M is 3.5%, and so on. We do this so all clients will be on the grid, so there's some pricing integrity because of this."

— VP of Sales at Supply Chain Management Services Company

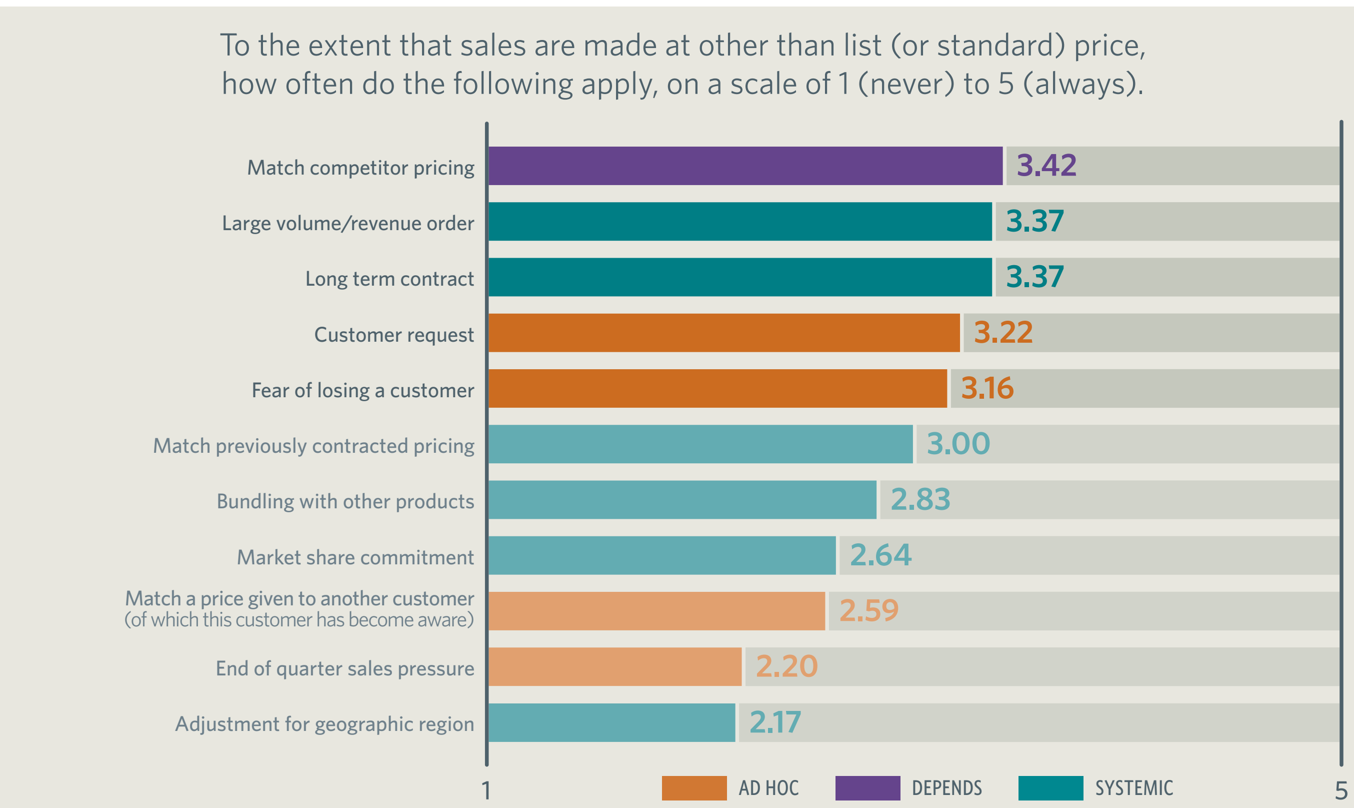
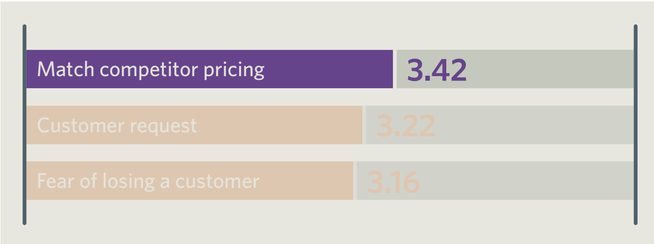


FIGURE 4



Matching competitor pricing: The top reason overall for granting pricing exceptions was to match competitor pricing (see Figure 4). Sometimes granting an excepting to match the pricing of competitors is a systemic reason. For instance, if the market has shifted and pricing has not yet caught up to the current competitive environment, making an adjustment to pricing on a broad basis in order to remain in line with the market is sound practice. This is simply a part of maintaining competitive position in the marketplace and certainly a defensible reason for making an adjustment.

More frequently, however, we hear of salespeople matching a competitive price to win the business on an ad hoc basis. Often, the "competitive bid" is actually an "apples to oranges" comparison, and the competitor's prices are not for a pure commodity that is indistinguishable from the product and service package you offer. Granting an exception based purely on competitor pricing can actually undermine differentiation and make future negotiations more difficult. It certainly rewards customers for going out to bid frequently. In addition, if one customer learns that another received an exception to match a competitor's price, they may demand the same exception – and it would be difficult for a salesperson to defend the actual price, even with provable differentiation, if a previous exception has already been granted on those grounds.

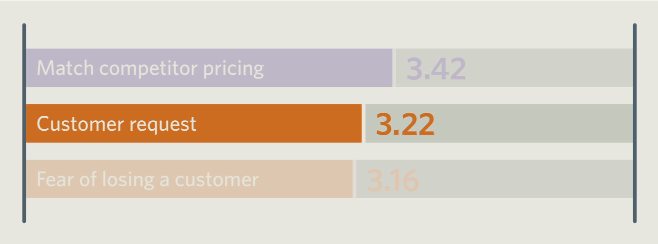
While granting an exception to match competitor pricing may sometimes make sense, such as if a customer were to truly walk away otherwise, if your product is truly an undifferentiated commodity, given the full potential cost of making exceptions, sometimes allowing these customers to walk away may be more prudent in order to preserve the integrity of your pricing structure. Your customers are your customers for a reason, of which price is only one factor. Customers likely choose your company for other reasons too (that the negotiator across the table may be loath to admit), like your quality and attention to detail, the importance of your products/services to their business, your customer service, proprietary design or technology, or ease of doing business.

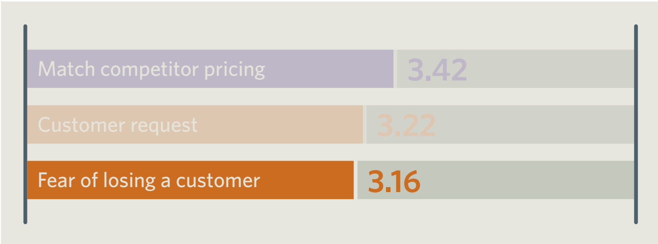
We recommend our clients take a careful and systematic look at the interests that their company fulfills for their customer and to then consider how well their competition can meet the customer's interests at the same time. Is price truly the only reason your customers stay with you? If the answer is no, you might want to reconsider and make a serious and systematic determination of whether the discount is necessary to win. Consider for example:

- Will your company fill an unmet need for the customer?
- Does your company provide truly unique value in some way?
- Can your competitors (or the customer on its own) match the value you can provide?
- Will your customer face risk or cost of switching if they went to a competitor?
- Will this customer, or other customers, expect similar discounts in negotiations down the road?

Every situation is different, but the more frequently you answer "yes" to the questions above, the more we advise holding firm on your price by focusing on selling the value of your company and the degree to which your organization beats your competition.

If you do need to cut your price to win the business, be sure to tie the pricing exception to something justifiable and of value to your organization as well — this will make it harder for the customer to use the adjustment against you in future negotiations (or worse, for other customers to use it against you). For instance, tie the exception to: a certain volume commitment or offer rebates once the volume is reached; longer contract duration with some protection for early termination; increased share of their business; or the purchase of other products in your bundle to the extent that is permissible in your industry. Discounting to win the business may at times be necessary, especially if your company's value is not differentiated; however, it should be done strategically and defensibly to avoid the downsides and market risks of doing so.





Customer request: Should you give in to a customer just because they ask for a pricing concession? It turns out that a customer request is one of the top five reasons companies cite for granting a pricing exception (see Figure 4). In order to preserve pricing discipline, we recommend our clients refrain from granting exceptions simply to meet a request (on the grounds that "if we granted it for you we would have to grant it for everybody"), but instead look for other ways to bring the price down for legitimate reasons if price is truly an issue to the customer. For instance, as above, could the pricing discount be tied to a higher volume purchase or to a longer-term commitment? Are there some additional value-added services or components of the purchase that can be taken out of the deal to legitimately reduce the price? Could the customer serve as a reference account, assist your company with improving your own products in some way, or offer value through other means? Granting exceptions "just because" trains customers to ask for them and expect that they will be granted, incents them to hold out in negotiations until concessions are made, and makes it that much more difficult to say "no" in the future.

Fear of losing a customer: Companies cite "fear of losing a customer" as the third largest ad hoc reason for granting a pricing exception (see Figure 4). This is an understandable fear given the impact the loss of their business would have and the time and effort it takes to acquire new customers, not to mention the effort that has already been expended developing the customer in the first place. That said, is simply granting an exception due to the fear of a customer walking out the door sound business practice?

Maybe it is if they have threatened to leave in the past, or if they have actually done so. Though every situation is different, if they have not threatened credibly to go to the competition, making such a concession based on our own fears may not be sound practice. Even if they have vocalized a threat to walk, choosing to make a pricing exception based on that threat may be unwise for a few reasons. Doing this rewards the customer for making the threat in the first place and incents them to do it again in the future. One must determine how real the threat is based on how well you meet other customer interests versus your competition — chances are your customer has chosen your company for some reasons other than price. Also, consider that if your company is serving end users who are not at the negotiation table, the buyer's threat to walk may well be hollow — your end users may need to be on board for such a switch to occur. While the prospect of losing a customer is frightening, when determining your reaction, it is important to assess the credibility of the threat and ways you can influence the likelihood of the customer following through with the threat (e.g. highlighting differentiation from your competition) before reacting with a pricing exception.

Ad Hoc Exceptions on ASP

Since ad hoc reasons make up three of the top five reasons companies grant exceptions, it is important to know the consequences of those decisions, the impact on a company's ability to maintain pricing being particularly critical. When comparing average ASP maintenance over time in companies that most often granted ad hoc exceptions (those who selected "Sometimes," "Frequently," or "Always" on the frequency scale on all three of the top ad hoc reasons mentioned previously) to companies that least often granted ad hoc exceptions (those who selected "Rarely" or "Never" on the ad hoc exceptions above) those that granted exceptions most often experienced much more rapid ASP decline (see Figure 5).

Over 30% of the companies that frequently granted ad hoc exceptions reported a decline in their ASP after only 3 months, whereas none of the companies who rarely or never granted ad hoc exceptions experienced decline during that time horizon. While some companies in both groups eventually experienced ASP decline, the companies that rarely or never granted ad hoc exceptions were much less likely to experience decline in the short term: after 2 years, the group that never or rarely granted ad hoc exceptions was 64% more likely to maintain ASP than the group of companies that frequently or always granted ad hoc exceptions.

The impact ad hoc exceptions have on ASP is one real concern, but are there other benefits that would likely outweigh that concern? This led us to test the other implications of deciding to make or refuse price concessions. Did companies that held the line on price lose customers at an alarming pace? Did companies that refused to grant exceptions see their customer satisfaction decline? Or did those companies that said "no" to an exception see the customer drag out their negotiations?

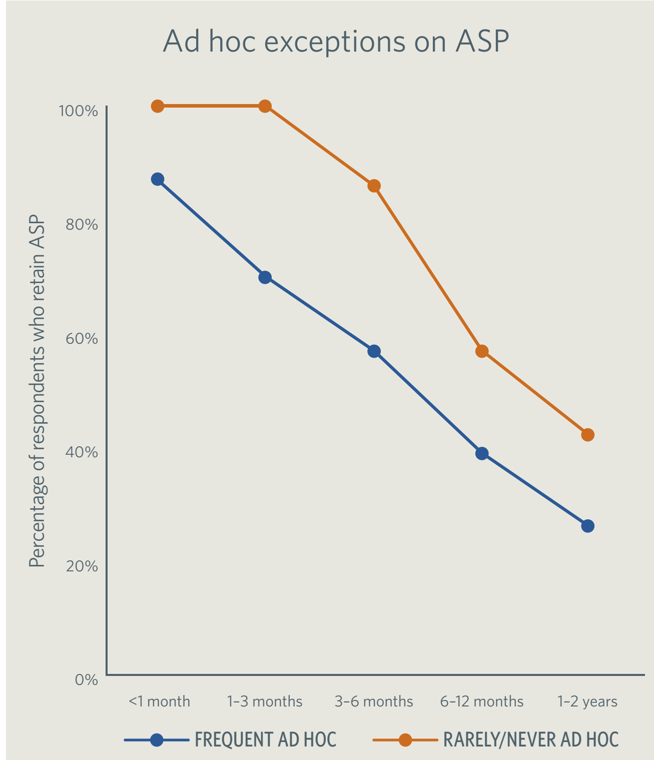


FIGURE 5

> Over 30% of the companies that frequently granted ad hoc exceptions reported a decline in their average sales price after only three months.

Implications of Making Exceptions

Knowing *why* companies make exceptions, we wanted to see *whether* these companies are actually able to achieve their desired outcome when they grant exceptions. Did those companies granting exceptions experience the higher customer satisfaction, increased customer retention, quicker and more efficient negotiations, and more highly valued products and services that they were looking for? To see the impact and implications of choosing to make or not make exceptions, we compared companies that reported that they tended to almost always grant exceptions (at least 75% of the time) with those companies that said they rarely or never granted exceptions (under 25% of the time) in their price negotiations.

Customer Retention

FIGURE 6

As described above, one of the biggest reasons that companies grant exceptions is due to a fear that customers will walk away if they do not drop their price. Since many companies seem to grant exceptions due to fear of losing a customer, it would make sense that when they finally do make these concessions, their customers stay, and those companies that refuse will lose them.

However, in comparing companies that "almost always" grant exceptions versus those who "rarely or never" grant them, we found that customer retention tends to be only marginally better in those companies that almost always make exceptions than in those that do not — companies that almost always grant exceptions averaged only 0.27 points higher on a 5-point customer retention scale than companies that rarely grant exceptions (see Figure 6). Customer retention is a multi-faceted issue (of which willingness to make a pricing exception is just one factor); however, based on these findings, refusal to grant exceptions does not seem to have a significant adverse effect.

Why might customers choose to stay with a company that almost never grants price exceptions at nearly the same rate as with companies that almost always grant exceptions? We hypothesize that in many cases they may psychologically value the products and services from these companies more highly, since the refusal to grant exceptions in many ways confirms and upholds their product value. It could also be that they respect the consistent, principled, and disciplined pricing approach, and take comfort that others are given the same treatment. They might also simply care more about quality, service, and other factors relating to total cost of ownership than simply price alone.

Sellers have more power in their negotiations than they may think.

Whatever the reason, these results suggest that customers do not value price as much as they express to salespeople in their negotiations — at least perhaps not enough to walk away over it as frequently as they threaten. All things being equal they would prefer to pay less, but customers value other factors such as quality, customer service and satisfaction, switching costs, stability, or their longstanding relationship, as much as or more than price. Given this, granting exceptions out of fear of losing a customer is rarely justifiable without the customer's explicit and overt move to walk away. Based on this finding, we would recommend not making exceptions purely on the basis of fear, and certainly not without conducting a thorough competitive analysis to confirm the possibility that the customer may be better off with a competitor. It is important to remember that sellers have more power in their negotiations than they may otherwise think.

Speed of Negotiation

FIGURE 7

Many salespeople request an exception to speed up a negotiation and "just get the deal done" — maybe a quarter is approaching its end and quotas have to be met, or a salesperson is tired of a deal continuing to drag on. Thus, a concession is granted just to close the deal. Salespeople sometimes give the customer what they want in order to get them to sign, under the theory that matching the customer's pricing request, or at least meeting them partway, should speed up the negotiation and free up valuable time to focus on other sales.

Our study indicates that companies that more readily grant exceptions to their customers did not report increased speed or efficiency in their negotiations over those companies that refuse pricing exceptions (see Figure 7). Salespeople who choose to grant exceptions simply to speed up a deal may be teaching their customers to expect these exceptions in the future. Therefore, instead of speeding the process along, customers are taught to hold the negotiation hostage until a concession is granted, and may hold their ground even longer in the next negotiation. Conversely, with companies that rarely or never grant exceptions, though customers may initially push for concessions off list price, they quickly learn that the company will not budge in their pricing, and their options become to either accept the price, or exercise their often less desired ability to go elsewhere.

> *"Usually we have repeat business with customers who know our quality...so we don't need to throw many arguments into negotiations because customers know what to expect."*
>
> — Sales Director at a Steel Production Company

Giving in on price to speed the negotiation along feels tempting, but doing so tends to actually produce the opposite result — incenting customers to hold out and drag on negotiations until they get the best exception they feel is possible. Instead, staying firm on price results in equally efficient negotiations over time, and better maintains ASPs.

Customer Satisfaction

FIGURE 8

Even if an exception doesn't necessarily speed up negotiations, it will at least improve customer satisfaction, right? There is a common perception among salespeople that granting exceptions will lead to happy customers and increased satisfaction levels. However, somewhat surprisingly, this data shows that customer satisfaction seems to receive only a marginal boost from making pricing exceptions — though it is a boost nonetheless. If you are trying to "buy" customer satisfaction by granting a pricing exception, recognize that the likely increase in satisfaction may not be significant (see Figure 8).

Given the cost of pricing exceptions, considering ways to increase customer satisfaction besides granting a discount is prudent. For instance, are there ways in which you can lower their costs of doing business with you without reducing prices?

> *"Pricing and customer satisfaction are loosely linked."*
>
> — Key Account Manager/Director at Insurance Company

Doing so would enhance the partnership with your company and increase customer satisfaction if measurable improvement can be found, while preserving ASP. Are there terms that you can offer to them that are not of consequence to your business, but beneficial to theirs? Perhaps you could extend payment terms in exchange for them being a reference account. Avoid setting a bad precedent and accelerating declining ASPs by developing creative solutions to meet customer needs in ways other than price.

Value and ASP

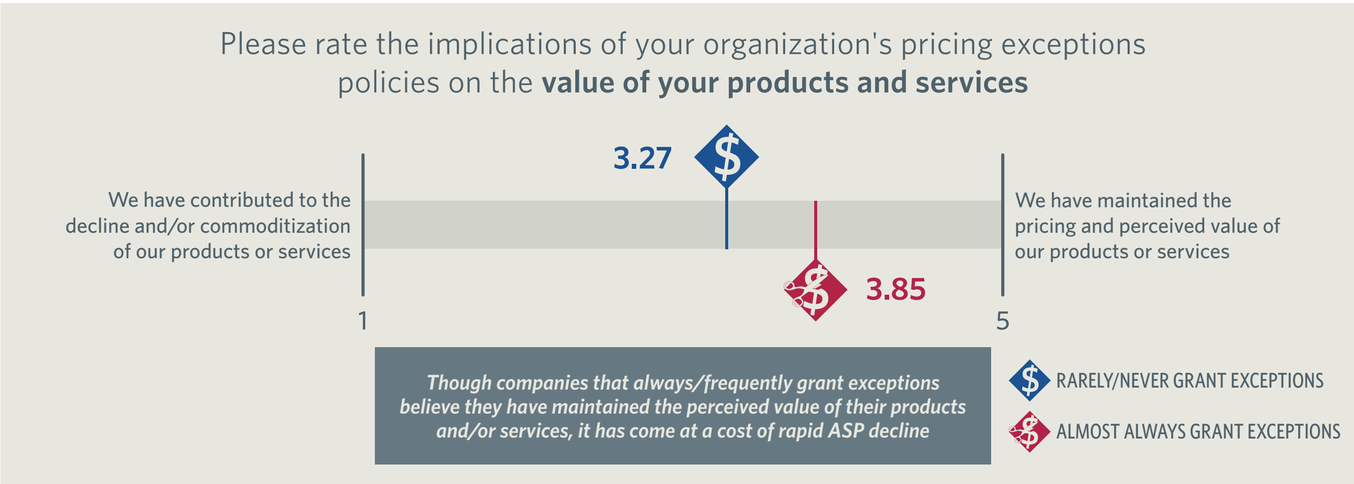


FIGURE 9

When asked to rate how their company's pricing exception policies have impacted the value of their products and services, companies that frequently or always grant exceptions averaged 3.85/5.00 (see Figure 9). This was higher than companies that almost never grant exceptions, which averaged 3.25/5.00. This indicates that most companies granting exceptions believe they have maintained the perceived value of their products and services. This makes sense as the "principle of contrast" shows that offering a discount on a higher-priced item may make the customer feel that they are indeed getting a great value.

However, despite maintaining the perception of value, doing this comes at a steep cost. When these same companies that frequently or always grant exceptions were asked how granting exceptions affected their ASPs, 50% reported they see a drop in ASP to the newly excepted level in less than 12 months, and an additional 20% see a drop within 1–2 years (see Figure 10). The lesson from the data is to understand the true potential cost of making the exception before it is made.

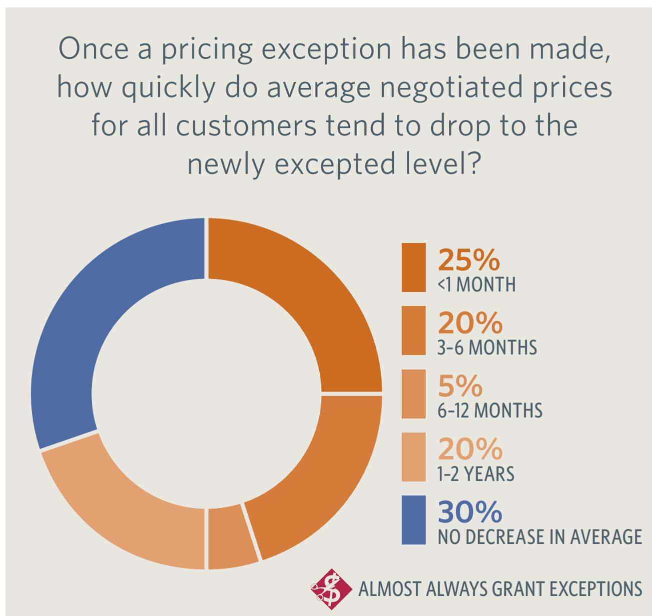


FIGURE 10

Managing the Risks of Enhancing Pricing Discipline

Implementing improvements in pricing discipline is hard work.

Making the choice to improve pricing discipline, slow ASP declines, and rationalize pricing across customers may sound great on its face, but implementing such strategies is hard work, not without tough decisions, and may require that you walk from some customers (or expect they will walk from you).

Given this, our common experience tells us that it is important to be cautious in rolling out any effort to improve pricing discipline. In doing so specify the profile of customers your organization is willing to let walk, those that would not be ideal to lose, and those that you absolutely cannot afford to lose, as all customers are definitely not going to come along. It also requires a strong stomach, for some price-sensitive customers will walk to see if they can do better elsewhere. At the same time, sending a clear message that the company will not make pricing exceptions without a clear and defensible reason requires a commitment to see the plan through. Backing down and caving to threats sends mixed messages and continues to reward the customers that are most difficult.

Most importantly, this strategy requires that price is set at a level that is defensible by the sales team, commensurate with the value the customer receives, and within the market. It goes without saying that being firm on pricing that is not justified by the market is a recipe for disaster. Under such a regimen it is equally important to be able to be flexible, creative, and agile enough to develop deals with customers that meet both sides' interests well, and to ensure you agree to deals that you would make with other customers in the same circumstances. For instance, if a customer wants a lower price, and is willing to extend the purchase commitment for a longer term, that deal would be defensible and something to do again with many other customers (assuming the price cut is commensurate with the value of the deal extension). However, if a customer demands a 15% price cut because they are looking to drive cost out of their own production line, that may not be an argument that holds water.

Finally, for any corporate initiative for more disciplined pricing to be successful, it is critical that your organization sets up the structures, metrics, and incentives to support more disciplined pricing approaches. That means setting field sales incentives based on ASP maintenance, margin, and pricing integrity rather than only top-line sales. Likewise, individual performers should not be "punished" by sales management for culling customers who choose not to make the transition with you to more consistent pricing. In addition, ensure that there is a speedy, responsive, and credible pricing exceptions process in place, so that sales teams work within it and not around it, and that customers are not left waiting. Finally, sales teams must be given effective means to justify their pricing and explain why it is appropriate in the market and given competitor's offers. This means significant internal coordination with Marketing, Sales Ops, and, sometimes, R&D will be required to define the value proposition, supporting sales materials, and appropriate messaging. Thus, moving to more disciplined pricing to protect ASPs must be viewed more as a change management exercise than simply a corporate decision.

Recommendations

Take a hard look at pricing exception policies to make sure they are not contributing to declining ASPs.

Companies make exceptions for all kinds of reasons — some sound and justifiable, and some not. Regardless of the validity of the exception, those companies that grant exceptions more frequently are likely to experience ASP decline — in some cases quite rapidly. Granting pricing "adjustments" for commercially sound reasons, such as a large volume order, a longer term contract, or in trade for taking certain goods or services out of the deal, makes more sense and lends credibility and defensibility to the choice to discount. However, making pricing exceptions for reasons that are not justifiable, such as for fear of losing the customer, or just because a customer asked for a discount, rewards the customer's "bad behavior" and in many cases still does not achieve the desired results (like greater customer retention, or increasing customer satisfaction). In fact, giving in on price sets a precedent that will make future negotiations all the more difficult, as customers begin holding deals hostage until they receive yet another discount. Some organizations have found that they give their worst customers the best pricing, and over time they train their best customers to demand discounts.

These lessons are important for sales teams to remember when considering whether to grant an exception, as they often have more power in their negotiations than they think, given the customer's broader (and often unstated) interests in quality, customer service, speed, dependability, and the like. Moreover, companies that hold the line on price still seem to achieve high marks for customer satisfaction and the value their products and services provide. While customers may be happy with an unjustified discount initially, over time it may lead to customer perceptions that they are not getting a good deal or that their supplier's margins are so high that there is room for the price to go still lower.

Based on these study results, and our advisory experience working with Fortune 500 sales organizations, we recommend companies take a hard look at their pricing exception policies to make sure they are not contributing to their own declining ASPs. Instead, in order to combat a legacy of discounting (or to ensure that it does not become prevalent in the first place), it is critically important for sales organizations to have a clear process in place for determining when and why pricing adjustments are granted. Such a process should provide clear guidelines to sales teams for granting appropriate discounts for justifiable reasons such as volume or share commitments, signing longer-term contracts, making certain delivery concessions, or the like. When extenuating circumstances arise, as they always do, an escalation mechanism should be in place to ensure that any discounts granted are within the tight bounds of what has been, or would be, agreed for other like customers, to prevent price erosion and maintain pricing legitimacy.

As important as it is to set and stick to a clear pricing regimen, it is likewise necessary to support sales teams to ensure that they are able to execute it. To do so effectively, salespeople need to be equipped with clear and justifiable reasoning to explain to customers why the price is what it is, as well as when and why the organization is willing to deviate from it. This way, both salespeople and their customers clearly understand why a price adjustment could be made — or not. Doing so brings stability, consistency, and discipline as customers and sales teams know what to expect, and what will be approved and what will not. This also empowers sales teams to better explain and justify the value of the products and services they provide, rather than apologizing for prices the customer thinks are high. Doing this reinforces a commitment to fair pricing, so that the customer knows that other customers are not being treated any differently.

Summary of recommendations

- Determine the extent to which the organization's pricing exceptions policy is contributing to ASP decline
- Ensure there is a clear process and guidelines, and, when needed, an escalation path is in place for determining when and why pricing adjustments are granted — and that the sales teams knows what this is
- Ensure sales teams are equipped with clear and justifiable messaging to explain to customers why the price is what it is
- Build a mechanism to track pricing exceptions over time, including who made them, why, and the impact they had
- Ensure sales incentives are aligned with promoting increased pricing discipline and do not reward "bad deals"

"The only time we make price adjustments it is when there is a verifiable competitive threat. I need to see a piece of paper and an offer proving this is real and verifiable — then we can talk about it. If customers ask for an adjustment we won't give one away for free. We definitely ask for something in return. You pay faster and we reduce payment terms, or you extend contract terms."

— Key Account Manager at Chemical Company

That said, such supporting data, metrics, and messaging support generally does not come from the field sales organization — instead it needs to come from Marketing, R&D, and Sales Operations — those closest to the data. Such data can be provided to the sales team in a variety of ways; presentations, training, playbooks, suggested talking points, or other marketing materials to convey the data are all helpful tools. Providing a suite of tools may be most helpful of all, as that gives the salesperson flexibility to determine the medium most appropriate for a given situation or client.

In addition to messaging and data explaining why the prices are justified, it is also important to have a system in place to track pricing exceptions if and when they are made. This should include who made the exception and for what reason, so that the organization can holistically consider the impact pricing exceptions have on the market. "One salesperson" who makes "just one exception" might quickly add up to an entire organization with little discipline around pricing, and little ability to defend the pricing it has set.

Finally, in order to combat the urge to close deals at any cost — even those that are not in the best interest of the overall organization — the sales teams' metrics and incentives need to be structured to promote walking away from "bad deals," in whatever way they may be defined. Incentives could be based on, for instance, margin, adherence to pricing guidelines for certain deal sizes or duration, maintaining or enhancing ASP, or increasing customer share. Likewise, the salesperson should be held harmless (or even remunerated) for deals that the organization decides to walk away from, assuming the customer was of a certain size, the deal was escalated to a pricing committee, and/or on which the salesperson worked for a certain period of time.

Negotiating pricing exceptions are a standard part of nearly every business. Determining when and why they are made, and how they are communicated, are essential components of any pricing strategy. That said, whether considered or not, we see that all too often salespeople do not follow through with set pricing strategies. As procurement organizations become more sophisticated, end users become more knowledgeable and market savvy, and competition grows fiercer, the ability for salespeople to defend their price with clear rationale and justification only becomes more essential. It is critically important to stay the course and not undermine pricing decisions by granting exceptions without sound business reasons. It would be even better to only offer customers pricing adjustments based on clear criteria that are consistently applied across the organization's customer base.

Undoubtedly increasing pricing discipline after years of giving in to customer demands will lead to pushback (for which sales teams need to be well prepared), and some customers may even walk away. Navigating a transition to improve pricing discipline is undoubtedly difficult. However, once in a steady state, if the price is fair and defensible within the market, salespeople are equipped to clearly explain and justify that price, and pricing discipline is consistently applied, the data indicates there will be minimal, if any, negative impact on customer retention, satisfaction, or negotiation speed and efficiency (and indeed positive impact in some cases), while reaping the benefit of maintaining ASPs. While each company and each industry is different, and more study is needed to confirm the true value of maintaining pricing discipline, this initial data points in a clear direction, and certainly raises questions every company should look to answer.

About Vantage Partners

Vantage Partners, a spin-off of the Harvard Negotiation Project, is a management consulting firm that specializes in helping companies achieve breakthrough business results by transforming the way they negotiate and manage relationships with key customers, suppliers, and alliance partners. Leveraging over 25 years of experience consulting to F500/G1000 clients, our Sales Advisory Practice works with sales and marketing leaders to develop the strategies and organizational capabilities needed to strengthen and grow their most strategic customer relationships, deepen and broaden solution selling, successfully manage RFPs and other purchasing strategies, substantially improve negotiated results, develop true pricing discipline, and select and enable their go-to-market partnerships.

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