

7 Myths and Sins About Pricing

Businesses are finding out their pricing isn't generating the profits they need to sustain and grow their businesses. Some have depended on assumed logic and myths that have caused them to not generate cash profits and have become lazy in the way they treat their pricing. With the shrinkage of the market size, just about all are forced re-examine they're thinking about how they deal with pricing, processes and profit.

So what is your reaction as a business executive? As your business has down sized and become leaner (hopefully), have you lost focus on profitable pricing? Margins slipped? I'll bet margins have slipped more than you care to verbalize. Calls to my office indicate there is confusion about prices and many are unsure of how to regain and improve. You need to examine what you believe about pricing (probably myths) and get that out of your mind. The question is, are you willing to explore what you believe, assume and maybe enforce about pricing?

So, the first step is to examine what you have come to believe that are really myths and the second thing is to replace the myths with laser focus on pricing that can generate greater net profit of same sales or and expansive growth.

- Myth #1** The market sets my price levels
- Myth #2** If a competitor cuts prices, I need to cut prices
- Myth #3** My prices should be based on 'cost'
- Myth #4** I've got all my cost covered
- Myth #5** My pricing is simple
- Myth #6** My prices cover every type of customer we have
- Myth #7** My customers don't remember what I charged them last time

Myth #1 The "Market" sets my price

To a certain degree the overall market does exert price pressures on generic items (petroleum, metals and etc.) that are generally recognized in the market place. But, if you believe that the "market" controls your pricing, then you are missing profit opportunities.

The basic premise is that if you stock product you can assign a different price for different types of customer depending on whether you offer credit, sell in volume and get paid quicker (or within your credit terms), stock product by contract that has a



slower volume movement, retail sales at a counter area, staging products for a project, delivery to different floors or roof tops. Or you can set a price based on some activity that you would not normally offer to the bulk of your customers.

Many executives know all too well that the “market” is often their salesperson carrying news back that the “market” price is such and such! The easy way out of hearing that message is to investigate the ‘market’. Spending time looking and listening to the market is the way to grow profit.

Myth #2 If a competitor cuts prices, I need to cut prices

Most competitive business people buy into this myth. The business landscape is littered with price cutting competition. The urge for some business executives to meet or beat competition is so strong that they will blindly meet or beat a competitor and worry about profit after they have the order in hand. If it becomes personal all bets are thrown out the window when it comes to profit.

To illustrate this point, while presenting to a group of distributors, I asked for a show of hands as for all that knew which competitors were known for low prices. About 70% raised their hands. Then I asked how many competed down to the final order and won. Again about 70% raised their hands. The final question was how many of you ‘think’ or know that you made money where they competed on price and this time only 12% of the hands went up.

At the break, I was questioned about the word ‘think’ they made money and the explanation is simple. Very few people who engage in low price as the driver of the sale actually make money....keeping in mind that hindsight is 100% if you are honest with yourself.

Smart business executives don’t really buy into this myth. So, there are some parameters you might want to consider before diving into the water of price cutting to meet or beat competitors.

There are three main mental battles that a business executive should engage in:

1. Selling value and service. If you have a tough time with that then you need to make sure that you cover your bases with # 2 below.
2. Maintain margin on both the line items and total order. After that then you should run the ultimate risk/reward test. Credit vs. margin and collection
3. The credit worthiness vs. margin. It is a risk reward situation that only you can judge at the time it happens. Volume is not all it is cracked up to be. But profit sure is.

There is work involved in when you decide to lower prices. Often times the work of making sure there is proper margin is overlook and defaulted to sales. Computer systems can be set up to handle the task, but it still needs to be verified. Then there is the matter of SPA’s, which to some is like paying a higher price for product and then having to collect from the manufacturer. Net prices solve a lot of those problems, but I would no expect them to go away anytime soon.



If you come away with nothing else out of this Myth #2, here is what it should be: You can't be low on every order! If discounting is part of your business plan, then you need to plan ahead and document it. The ultimate SIN with this myth is thinking that you have to be low on every order and it becomes personal.

Myth #3 Sell prices should and must be based on "cost"

If you believe this myth and it is the way you currently price product, all the discussion about this myth is over with and I personally wish you good luck. Personally I don't think you actually know what your 'cost' is. There is a reality that most distributors have to deal with and that is with all the SPA's, rebates and double backs, most distributors don't know their real cost until the year is over with.

To get back to executive reality, there are a number of studies, some older than others and some that are current, that businesses make more money selling off of a List Price, MSRP or resale price. In plain English manufacturers post a 'benchmark price' that all can see to establish a perceived value or buying range. The buyer never knows for sure what your cost is.

Why? The simple reason is that prices that are exposed to the buying public, and that means your customer base, tend to make value judgment and remember the prices they see on regular basis. Here's a quick thought: You probably drove by a gasoline station or 7-11 that had a price per gallon for at least three and maybe four types of gasoline. Did you make a mental note of what the cost was? I think you did.

The fact of the matter is that prices will change and there are all sorts of factors that cause prices to change. Most businesses sell multi types of products that have different sizes, packages and are bought in different usage quantities. Therefore the same physical single item could be packaged differently and have a different price.

Take it from someone who has been on the buying end, that manufacturers go to great length to disguise your cost to you and your competitors. If you can get a Net into Stock price for all your items, you have reached a success plateau that most businesses people never reach. So 'benchmark pricing becomes the way for a business to discount down from and not expose their true cost for a product. The smart business people don't even tell you what the discount from the benchmark price is.....think about that.

The basic problem with basing your selling price up from 'cost' is that you will spend a great deal of time checking that price before you sell the product. Most businesses want to gain more throughput, meaning selling more products for the same overhead cost, which in turn helps the business make more profit.

So to assume that you know your cost for each item in your inventory, you are making a really bad assumption. You need to remove this assumption from your thinking and beliefs.

You will make more money if you use a reliable benchmark price to figure sell prices. Of course the trick is to find a reliable benchmark to work with.



Myth # 4 Prices cover all cost

This particular myth, when verbalized, invites everyone within hearing distance to hold his or her breath collectively. Virtually no one knows for absolute certain. If you know for absolute certain that you have all your cost covered in your current pricing structure, you are one in a million. Congratulations.

But in the real world, let's be honest with your self. Most people set up their pricing maybe originally or they inherited what they thought was a really 'cover all' pricing scheme. If you set it up from scratch, it was a real pain in the rear because it took so much time and you weren't selling anything. Plus you probably generalized on some assumptions and applied those assumptions across products that may require a different pricing structure. Here is the thing, depending on when that was done, that is history and markets have changed.

So if you believe in your heart or hearts that you've got all your cost of doing business reflected in your sell prices today, I challenge you to take a look. Now we are not going to place a bet on the results, but I will tell you that the house odds are on my side of the table.

Let me be blunt about this problem. Over the years as I have worked with various distributors, this is the largest problem that distributors have with their pricing. You will make anywhere from 2-7% more net if you bring you pricing schemes to reality. And in today's world it may not take a BIG project to get those profit dollars.

Myth # 5 Pricing is simple

And pigs fly.

If you talk about pricing at all, it is not a well like topic until someone starts checking real profit and loss. Right?

But you started out with some pricing rules that don't get documented, understood or at least believed by the executive team. As time passes, virtually no one remembers exactly what was decided. And that was the short version of how pricing rules get muddled. It becomes complex as time goes by is a gross understatement.

What happens along the way is that 'business situations arise' or 'competition happens', 'market conditions call for change' and prices get changed and not documented. The low person on the totem pole gets assigned the job, of 'handle pricing', in addition to their other jobs.

And you may wonder why margins slip?

Pricing can be as simple or complex as you want. The problem is if you don't document the rules, you will remember something that may not be akin to current reality.

Further down the road you can have an unplanned for sales increase to the point where your competitors are actually buying product from you cheaper than they can from the same manufacturers. But that is a horror story for another day.



So, is pricing that simple? It can be if you address the issue like real profit depended on it.

Myth #6 Prices cover every type of customer

This myth is akin closely to myths #4 and #5, “I’ve got all my cost covered” and “pricing is simple”. This is common myth/ belief that you think you have planned for every type of customer. It plays mental tricks on most business executives. Business executives convince themselves that they have allowed for every type of customer, which implies that they have thought beyond just wanting to sell a specific product and make a profit. What is really a hoot is when they try and convince someone like myself.

Let me submit to you that while you may have thought through the sales price to one type or even many types of customers, the market has changed and there are greater opportunities to sell additional products as add on or companion type of sales. There is another type of customer that often goes undetected and that is the type of customer who ends up paying with a credit card after they have exhausted your company’s CREDIT patience. Virtually no company pre-plans for this type of customer.

Myth #7 Customers don’t remember what they were charged the last time

Really? You really should stand up and look in the mirror and say that to yourself again. If you have repeat customers that buy the same items over and over, they will zero in on your prices. If you still don’t believe they remember the prices, just announce a price increase and see how many accept that announcement with out comment. If you have any fingernails left after that announcement, give me a call and tell me I was wrong. Just remember they do know your prices.

Myth purging from one’s mind can be hard because you have accepted them as fact, probably for years. Myths become reinforced with business interaction with fellow employees, manufacturers and customers. Myths turn into sins when you continue to believe them over and over and you still expect a different result.

Thus I have not been a big fan of PAR reports because they reinforce metrics of what average distributors do. While these are good benchmarks, there is an assumed myth that many businesses strive to become average instead of developing their total potential market place. Changing the way you think about pricing and then becoming focused on taking action to develop prices that increase margin will yield anywhere from 3 to 7 points of additional margin!

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So, the defining question about the way you think and act about pricing is: Is there enough money at the end of the tunnel for you to take action? Or do you fall back into the old myths.