MFL THE PRICING TIMES

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PRICE RIGHT, DON'T COMMODITIZE YOUR BUSINESS

Now, more than ever, pricing right should be a top priority for CEOs. The world as we have known it has all but disappeared. We now are all facing a slasher-thriller that keeps us up at night and sends chills down our spine.

1. Collapsing demand
2. More aggressive buyers with stronger procurement capabilities and on-line access to product and price availability
3. Increasing pressure from global competitors with labor and other cost-factor advantages and excess industry capacity
4. Declining raw material costs – that we all used to justify recent price increases
5. Hard to reduce cost structures – we have already "gone lean", been six-sigma'd, and implemented across the board staff reductions.

Instead of refocusing and using better pricing practices, we now see businesses increasingly implementing conventional wisdom actions to further slash costs. But unless you are, and can remain, "THE" low cost provider in your industry, these actions have unintended consequences – they COMMODITIZE your specialty business.

These conventional wisdom actions, as logical as they appear, will most likely exacerbate, not reduce, the damage from these pressures on your business.

Why? Our old friend the Value Equation, once again, tells the story. If you look at your business from the outside-in, versus the inside-out, you will see how many common business practices reduce benefits and can commoditize / damage your business

In tough times, conventional cost cutting moves often run counter to effective pricing. Typical actions of these tough times; simplifing and narrowing product and service offerings, cutting back direct sales and application engineering staff, reducing inventory and lengthing lead times, and reducing marketing expenses, result in reducing real and perceived customer benefits. In addition, there becomes a risk of losing existing business because of a reduction of switching costs, costing volume, share and margin.

We are not suggesting, of course, that you avoid taking tough actions to reduce costs. Rather, we believe that cost reduction actions taken with an outside-in view can be productively accomplished without reducing delivered and perceived benefits to customers. However, this often requires changes to counter the internal drivers of commoditization – inside-out mindsets and unaligned metrics and incentives.

Organization mindset in reaction to the current environment often leads to ineffective pricing

Mindset	Consequence
"Any order is good order"	*Cut price to fill the plant with low margin and non-strategic business*
"Cut price on business we cannot win to punish our competitiors"	*Price war, because our low price becomes their perception of our price*
"Focus on the big accounts. In this environment we don't have time or resources to serve small accounts"	*Limit growth and walk away from low competitive intensity, high profit orders*
"Complexity is bad, we will lower operation costs if we reduce complexity"	*Walk away from accounts willing and able to pay for customization or cut price to balance an offering that does not fit customer needs*

Misaligned organizational metrics and incentives exacerbate the situation

Volume based sale incentive/commission	*Drive volue at any price. Signifigant downward price pressure.*
Cost-based price minimun gross margin	*Loss of sales that would truly generate attractive bottom line and cash flow and often a cap on margin for high value offerings*
Every function drives to maximize their own functional performance - pure functional metrics - e.g. lower inventory days	*Out of sync functional practices - e.g. reduced inventory levels cause loss of sales or reduced prices*

Can you do anything about this - and make the most of today's challenging business environment?

YES YOU CAN!

We have seen businesses across the full range of operating modes outperform their competition by building the capabilities and discipline to choose where to compete and link how to get paid. Accomplishing this does not take a great deal of rocket science, but it does take strong and focused leadership to:

1. Find and close price leaks – do not wait
2. Take an Outside-In View of your business and the decisions you make

3. Avoid the conventional wisdoms often do more harm than good
4. Recognize that choosing where to compete and how to price are the final integrating elements of your business strategy
   a. Find and pursue your sweet spots - Not every piece of business is a good piece
   b. You can not win business and get paid unless you deliver real benefits to customers who are willing and able to buy
   c. The final piece of the pricing decision is whether you want the order, not what price to set
5. Align mindsets and incentives across your organization, do not depend on directives, edicts, and computer programs to get it done
6. Keep your eye on "the pricing ball" – to avoid
   a. New leaks springing up and getting bigger
   b. Conventional wisdoms resurfacing and costing you big dollars
7. Remember the value equation

PRICING BEST PRACTICES IN TOUGH TIMES

1. Know the value you deliver to your target customers and how they buy
   a. Detailed knowledge of application economics by customer/application (can vary for the same customer depending on specific conditions –e.g., lead time value of magazine cover and insert paper
   b. Perceived value of all elements of product/service offering by function within customer's organization and channel participant
   c. Switching costs by function and buying influence
   d. Buying process by transaction
   e. Management and buying influence metrics
2. Develop ability to predict competitor pricing actions and reactions
   a. Their customer/application focus – sweet spots and priorities
   b. Product and service performance comparison in the eyes of the customer
      i. Absolute
      ii. Relative to you
   c. Product and service development focus
   d. Economic structure and financial capacity – P&L, Balance Sheet, cash position
   e. Management background, skills, and incentives
   f. Pricing process
   g. Pricing policies – e.g., terms and conditions, invoice content and language, freight, minimum order size, etc
3. Collect and analyze your own data
   a. Actual offering elements delivered to each customer/application
   b. Pocket price per order/transaction
   c. Actual cost to serve by customer/application
   d. Causes of the price band by offering
   e. History of price communications by customer/application
4. Utilize a productive, fact-based, and internally transparent pricing process
   a. Document and communicate clear price policies across the organization
   b. Align price strategy and communications with objectives for each audience that can track or is impacted by price
   c. Separate decision on price level from negotiation approach
   d. Separate strategic and tactical price decisions and review
   e. Carefully control all price communications
      i. Who can say what to whom
      ii. Avoid power transfer communication mechanisms – e.g., list prices and discounts
   f. Empower people closest to the customer to adjust and negotiate price within preset limits
   g. Employ a frequent, full, and risk free pricing decision review process including all levels of people involved with making and executing pricing decisions.
5. Align organization metrics and incentive
   a. Reward higher price realization in both short- and long-term as long as target volumes are met or exceeded
   b. Normalize incentives to align reward with challenge (performance versus target price versus absolute price or profit level)