Get out of Price Competition!

How to optimize your Market Strategy and dramatically boost your Profit Margins

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e-books

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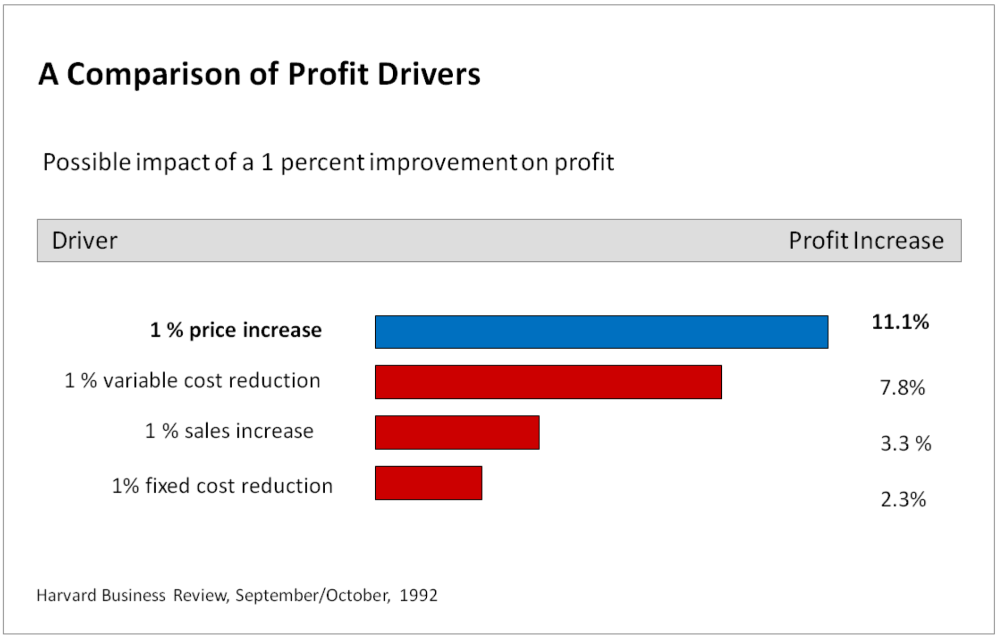
1. Increasing Price Pressure everywherel

The only thing that counts in our business is price! This statement is frequently heard across all types of industries. Many companies consider themselves caught in a ´commodity trap´ today: Their products and services are increasingly regarded as interchangeable and – so it seems - the only sales argument left for many organizations is to have a lower price than the competition.

The spontaneous reaction to increased price pressure is often to reduce prices as well in order to keep market share and survive in the competitive arena. But this strategy can rapidly backfire: Do-it-yourself-chain Praktiker aggressively promoted the slogan ´20% rebate on everything except animal food´ - and failed. Companies that implement an aggressive pricing strategy should know the price elasticity of their business: To compensate for the profit decline resulting from a 20% discount, sales have to almost double, given a typical cost structure. In most cases, this is hardly possible!

A look at a company´s profit drivers reveals that price – before cost reduction and turnover increase – is the strongest lever to drive profits. Figure 1 shows that a 1-percent price increase can boost profits by up to 11.1%, given the same sales quantity. However, the same logic applies the other way round: A 1-percent price reduction can lead to a decline in profits of up to 11.1 percent!

Figure 1: A Comparison of Profit Drivers



2. Achieving High Prices with strong Brands

Successful consumer goods manufacturers like Apple or Red Bull avoid price competition by leveraging unique, highly emotional brands. These increase customers´ perceived value and boost their willingness to pay a price premium. Even a ´commodity´ such as water can be marketed as a high-price luxury product if it is a strong brand. E.g. the US-based company Bling offers a luxury mineral water sold for up to 98 Euro per 0.75 liter bottle in European high-class hotels.

However, a strong brand alone is not enough – the products also have to keep the brand promise and offer a unique selling proposition in the eyes of the customer: Mobile phone manufacturer Nokia, the world market leader in 2001 who boasted a brand value of 35 billion dollars, missed the technological disruption caused by the smart phone and lost its competitiveness as a result. The company ended up in a crisis and was forced to sell its mobile phone business to Microsoft at the end of 2013.

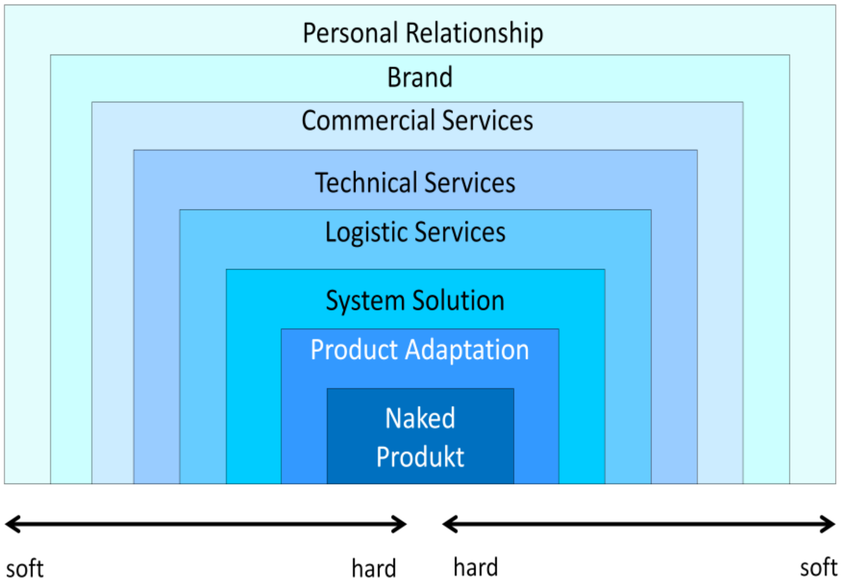
3. Building Unique Selling Propositions in B-to-B Markets

For Business-to-Business organizations, brands also play an important role as a Unique Selling Proposition. E.g. corporate brands like ABB, BASF, Siemens or IBM are associated with reliability, continuity and quality. These advantages can be the key factor in the customer´s purchasing decision and prompt him to pay a price premium. However, there are always customers which are hardly impressed by a company´s brand and which systematically look for the supplier with the lowest price.

This raises the question how a company can create added value for different customer groups and, simultaneously, differentiate itself from the competition.

The ´Benefit Onion´ offers suppliers a systematic approach to create added customer value and to build a Unique Selling Proposition (comp. fig, 2). The model shows how a company can create added value by offering ´hard´ and ´soft´ additional features. Starting with a ´naked´ product in the center of the model, a supplier can systematically expand its offering by leveraging the potential of the next ´onion skin´. The further the skin is located from the center, the softer the added value becomes and the harder it is to measure and imitate. ´Personal relationship´ is located on the outermost skin. It is difficult to quantify objectively, but it can nevertheless become the most important factor in the purchasing decision!

Figure 2: The Benefit Onion



Source: Based on: Christian Homburg, Heiko Schäfer, Janna Schneider, Sales Excellence, Gabler 2008

4. Leveraging new Profit Potential through focused Market Development

Organizations which are under strong price pressure often use the benefit onion with highly price-sensitive customers only to find out, to their disappointment, that these customers regard the added values offered as irrelevant and that they are, therefore, not willing to pay for them.

However, a detailed analysis of customer needs typically shows that not all customers exclusively purchase based on a low price. There are also customers which value long-term relationships and added features and which are prepared to pay a premium for these.

This insight offers suppliers an opportunity to segment their customers into different groups which are subsequently served with specific offers at different prices. The offers may range from ´naked´ products for price-sensitive buyers to service-intensive, tailor-made solutions for value-driven customers. By serving customers in such a differentiated way, companies can fully exploit the varying price acceptance levels of the individual segments. If they succeed in boosting their overall average price by only 1% (comp. fig.1) as a result, given the same sales quantity, this can lead to a disproportionate profit increase of more than 11%!

A needs-based customer segmentation is the first of 8 steps (comp. table 1) to counter price competition. The individual steps are described below:

Table 1: Steps to counter Price Competition

1	Segment Customers based on their Needs
2	Develop segment-specific Offers and Interaction Models
3	Create new Customer Needs through Innovation
4	Build a customer-driven Salesforce and qualify your Salespeople
5	Develop Tools for value-based Selling
6	Establish an integrated Customer Management
7	Manage the Change Project stringently
8	Measure Results

5. Step one: Segment Customers based on their Needs

Many B-to-B organizations segment their customers following the ABC principle or by distinguishing, e.g., between domestic and foreign buyers. These approaches are, however, of little use if you want to find out what specific needs your customers have, which parts of your offering are important to them and whether they purchase primarily based on price or value. To obtain this information, personal interviews with your salesforce and customers should be conducted. Interestingly, this often leads to quite contradictory results, with the salesforce usually tending to overestimate customers´ price sensitivity. In addition, it is helpful to analyze customers´ historical purchasing behaviour and the profit margins realized.

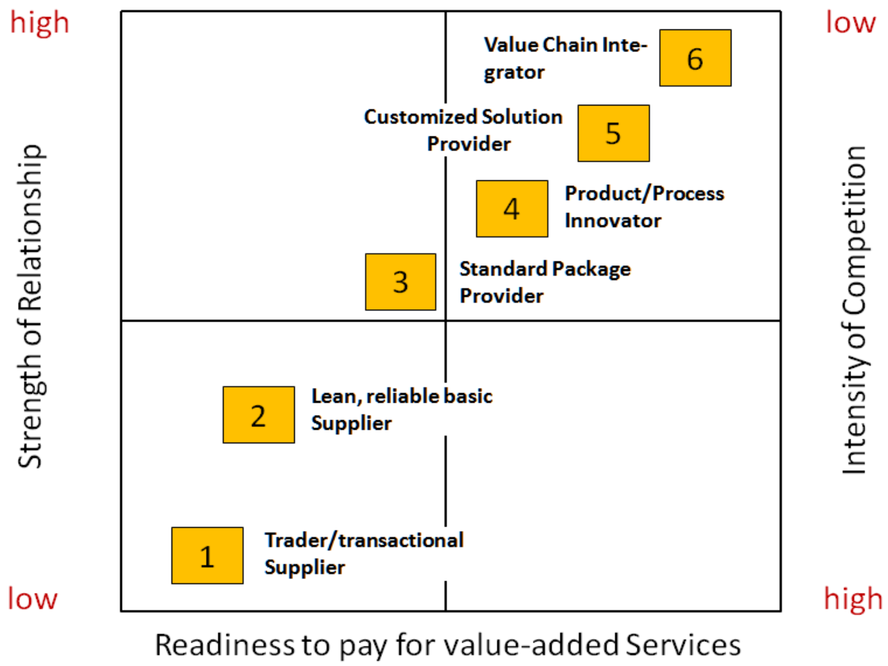
The principle of a needs-based customer segmentation can be illustrated using the example of BASF. The company divides its customers into 6 segments based on the two dimensions ´Willingness to pay for Service´ and ´Intensity of Relationship´ (comp. fig. 3). Customers located in the lower left-hand quadrant of the figure are primarily price-driven, transactional buyers. On the other hand, buyers located in the upper right-hand quadrant are primarily value- and relationship-oriented and, therefore, show a higher willingness to pay a premium for additional services.

The segments in figure 3 are named based on customers´ requirements for their supplier (BASF). Example: Segment 5, ´Customized Solution Provider´, means that customers in this segment expect tailormade solutions; they value an intensive relationship and they are prepared to pay a price premium for value-added services.

In the lower left-hand quadrant, competitive intensity is generally high as customers always look for more cost-effective solutions. At the opposite end, in the upper right-hand quadrant, competitive intensity is usually low as suppliers are deeply integrated into the customer´s value chain with their offerings and there is a close relationship.

Basically, a company has to decide whether it wants to serve all segments or focus only on a few. If all segments are to be addressed, the question arises if this should be done under the same brand name or with different brands. By using a multi-branding strategy, suppliers can better differentiate their offerings from each other and avoid ´cannibalizing´ their business.

Fig 3: Customer Segmentation at BASF

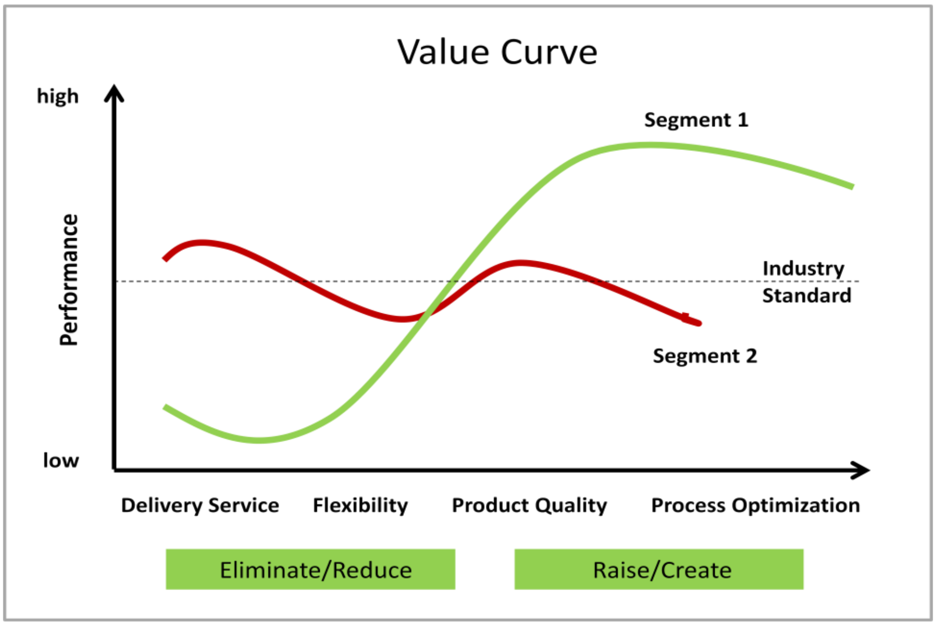


Source: Based upon: Christian Belz, Vertriebszeitung St. Gallen, 2014

6. Step two: Develop segment-specific Offers and Interaction Models

BASF has developed specific offers and ´Interaction Models´ for each segment to optimally serve its customers. As a methodical approach, the ´Value Curve´ (comp. fig. 4) was chosen. It shows how companies can eliminate, reduce, raise or newly create individual elements of their offers based on the key success factors (needs) of the individual segments.

Figure 4: The Value Curve



Source: Roland Deiser: Designing the Smart Organization, Wiley, 2009

Figure 5 shows BASF´s offerings in the Business Unit ´Performance Products. The 2 segments ´Trader/Transactional Supplier´ and ´Value Chain Integrator´ are not defined in this business unit. The figure also shows the supplier´s (BASF´s) segment-specific role (interaction model), customer needs and BASF´s pricing approach. Example: The segment ´Lean/reliable basic Supplier´ constitutes 40% of the performance products business. Customers in this segment leverage market opportunities and value the quality, sustainability and reliability of the offering they purchase. To meet these needs, BASF provides reliable quality, a sustainable product offering and benchmark cost leadership. With respect to pricing, the cost-leading supplier defines the lowest price limit here. Furthermore, the price is defined by the balance of supply and demand and it is important to mitigate market volatility.

Figure 5: Customer interaction Models in BASF´s Business Unit ´Performance Products´

	Lean/reliable basics supplier	Standard package provider	Product/process innovator	Customized solution provider
2011 % of the business	~40	~30	~25	~5
BASF	▪ Reliable quality supplier ▪ Sustainable product offering ▪ Benchmark cost leader	▪ Broader portfolio of products & services for differentiation in the market place	▪ Continuous stream of new products, systems and business models	▪ Customer-specific cooperations to fulfill unmet consumer needs
Customer	▪ Leverages market opportunities ▪ Values quality, sustainability and reliability of offering	▪ Values industry specific synergies & support	▪ Values innovation contribution	▪ Fairly shares value jointly created
Pricing	▪ Cost leader defines lowest price limit ▪ Supply / demand balance defines market price ▪ Mitigating volatility essential		▪ Value created along the value chain compared to market standard defines price level ▪ Product life cycle management essential	

Source: BASF Investor Presentation 2012

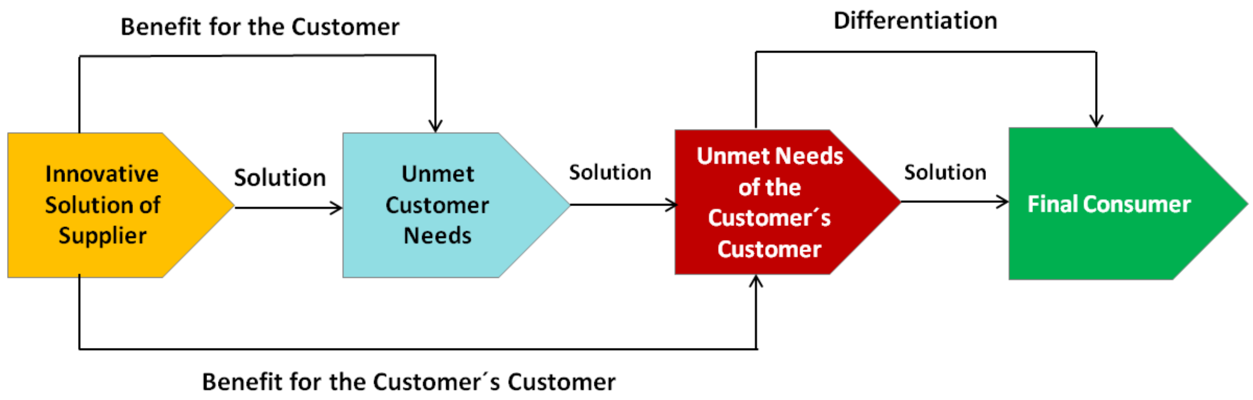
7. Step three: Create new Customer Needs through Innovation

Successful companies don’t content themselves with meeting existing customer needs only. Rather, to strengthen their competitive position, they permanently try to find out which unmet, unexpressed needs they can address with their innovative solutions in addition. To discover attractive opportunities, they analyze both their customers and customer´s customers in detail (comp. fig. 6).

Merck´s effect pigments business is a good example here. Building on the insight that about 70% of car buyers favour a car painted with a special effect irrespective of the colour, Merck enables its direct customers, automotive paint suppliers, to manufacture products with special colour effects. The paint manufacturers, in turn, sell the products to their customers, the car manufacturers. The latter then use the special painting to build a strong competitive advantage for their cars with the final consumer.

Concerning product innovation, business practice shows that companies often start far too late thinking about the customer value of their new products and to set prices accordingly. As a result, they come under heavy price pressure as soon as they launch their products and they miss their goal, which is to escape price pressure through innovation!

Figure 6: How to meet unfulfilled Customer Needs



8. Step four: Build a customer-driven Salesforce and qualify your Salespeople

A company´s salesforce is the spearhead of a focused market development strategy. To effecttively serve the chosen segments, salespeople with different profiles are needed: For the price-driven segment, sellers with a strong transactional focus are required to make sure that customers are smoothly and efficiently served with clearly defined products. On the other hand, the value-driven customers need relationship-oriented, consultative sales reps with whom they can jointly develop solutions to optimize their processes and boost business success.

To ensure that salespeople can assume their roles in the most effective way, historical sales results, personality types and qualification levels have to be analyzed and compared with an ideal target profile. To close the gaps identified, trainings have to be conducted in the next step. A key topic concerning the qualification of the relationship-oriented, consultative sellers should be value-based selling: Participants learn how to carry out an in-depth analysis of the customer´s business and of their position as a supplier. On that basis, they develop solutions which give them a strong competitive advantage and measurably increase their customers´ business performance.

9. Step five: Develop Tools for value-based Selling

Basically, an organization has 3 levers to improve its customer´s business performance: Sales increase, cost decrease and risk reduction. E.g., an industrial machine producer helps its customers to produce higher finished product quantities by offering better plant availability and/or to charge higher prices due to better finished product quality. The customer can reduce its electricity costs if the machine is highly energy-efficient and the supplier may take over the risk of a production standstill by offering a full-service maintenance contract.

To quantify the customer´s improved business performance financially, tools have to be developed which can be used by the salespeople when talking to customers. E.g., Excel®-based value calculators can be employed which map the customer´s processes and graphically show the financial results of alternative solutions. The more convincingly a seller communicates and documents this value, the better he can achieve a price premium!

10. Step six: Establish an integrated Customer Management

To serve customers in the most effective way by leveraging specific interaction models, a supplier´s entire value chain has to be aligned with different segment needs. In that context, the functions that have direct customer contact – Marketing, Sales and Service in particular – must closely cooperate and they should be strictly customer-focused.

However, business practice shows that this is often not the case. A lack of cooperation among functions and ´Silo Thinking´ dominate corporate cultures and make a coordinated approach difficult. Mettler Toledo, a Swiss manufacturer of measurement and precision instruments, has confronted this challenge by establishing cross-regional teams of specialists from Marketing, Sales and After-Sales Service. The teams are responsible for managing customers within the framework of an ´Integrated Market Management´. According to company information, turnover and profit have increased at above average rates against market trends as a result. (Source: Best Practice im Key Account Management, Redline Wirtschaft, 2005).

11. Step seven: Manage the Change Project stringently

Transforming a company´s market development strategy based on a needs-based customer segmentation is a change project which often involves revamping the entire sales organization and redeploying sales personnel. It is the task of management to actively drive this change forward and make it a success. A key aspect in this context is readjusting a company´s remuneration and incentive systems. In line with the goal of realizing additional growth potential, sellers should not only be rewarded based on turnover and sales results, but also for achieving contribution margin targets.

12. Step 8: Measure Results

At the end of the day, the success of the above-described steps aimed at getting out of price competition depends on whether a company is able to boost its profit through price and turnover increases whilst containing costs. Therefore, the profit drivers ´sales´, ´price´, ´discount´ and ´contribution margin´ have to be closely monitored through appropriate metrics which show the results achieved at the level of individual customers, sales persons and products.

13. Summary

Even in mature and saturated industries, there are opportunities to counter price competition. In most cases, markets can be segmented into price-oriented transactional customers and value-driven relationship buyers. On that basis, the chosen segments can be targeted in a highly-focused and specific way. As a result, organizations can realize new profit potential. Price competition can be countered by following 8 steps: Segment customers based on their needs; develop segment-specific offers and interaction models; create new customer needs through innovation; build a customer-driven salesforce and qualify your salespeople; develop tools for value-based selling; establish an integrated customer management; manage the change project stringently and, finally, measure results.

The Author

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Hans Walter Fuchs, MBA, is a Strategy Expert and Lecturer at the Hochschule für Oekonomie und Management, Frankfurt/Main (FOM). He holds a Master´s Degree in Applied Linguistics from the University of Heidelberg and a Master of Business Administration (MBA) from the Henley Business School, UK.

As Head of Marketing Services at Beneo, a division of Südzucker AG, Mannheim, Hans Walter was responsible for the international marketing of sweeteners to the confectionery industry. As a Product Manager for specialty chemicals at Bärlocher GmbH, Munich, Hans Walter managed a profit centre for specialty chemicals. As a Key Account Manager at Lahnau Akustik GmbH, Lahnau, he was in charge of European key accounts and coordinated a strategic alliance with the US partner.

In 2002 he founded his company, Hans Walter Fuchs International Consulting, which helps organizations to develop and implement international success strategies at the Business Level as well as in Marketing and Sales. The goal is profitable growth and superior business performance in the competitive arena.

Hans Walter is trilingual and offers his services in the same consistent high quality in English, German and French. His practical experience as an international manager enables him to quickly understand his clients´ situation and to develop pragmatic solutions. He has a passion for unconventional "out-of-the box thinking" and challenges his clients to develop and implement innovative approaches to lead their organization into the future.

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