Three Lessons That Both Buyers and Sellers Should Learn

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One of the challenges pricers face on a daily basis is maintaining value pricing strategies in the face of sales teams dealing with customers looking to reduce costs. However, as the cases presented in this article demonstrate, sourcing and procurement teams and pricing and sales representatives don't have to be enemies. In fact, they actually share the common goal of creating value as economically as possible. *Jan Yang (jan.yang@simon-kucher.com) is a Director at Simon-Kucher & Partners and Chris Yin (chris.yin@simon-kucher.com) is a Consultant at Simon-Kucher & Partners.*

In today's business world, no company can thrive without the support of its suppliers and no supplier can survive without the business of its customers. In an ideal world, buyers and sellers would work together to create value and help each other grow to generate a win-win situation.

Unfortunately, this is not always the case. As so often occurs, buyers and sellers frequently clash over value and price. Buyers complain, "The price is too high! Look at the market; this price is well above average!" And sellers typically gripe, "The customer is pushing me into a corner where there's no profit. It's as if they don't care about the value of our offer!"

Experience has shown, however, that win-win situations are, in fact, achievable and conflicts such as these can be avoided. Below, we'll introduce three lessons we've learned that explain exactly why.

Case 1: What you see isn't what you get – A lower price doesn't equal a cost-saving

The sourcing department of a blue chip company updates its supplier list every year. They use the suppliers' list prices to decide which suppliers to include. When stock needs to be purchased, the business department contacts a supplier directly from the list.

This year, the blue chip company asked a dozen suppliers to submit their list prices. Suppliers with higher prices were asked by the customer to accept a price level five percent lower than the market average. If they didn't accept, the suppliers wouldn't make it onto the list.

Some suppliers agreed to the request despite the fact that such a low list price wouldn't generate a positive margin for them. When the business department contacted them about specific projects, in order to maintain profits, the suppliers added non-standard items that weren't included in their list prices and that didn't have an available market price.

In the end, although the suppliers' list prices were lower than the year before, the customer didn't save as much on costs as they'd expected.

Lesson learned: Costs are not just prices; prices are only the tip of the iceberg. Merely cutting prices doesn't mean buyers will save on costs. While buyers may want to lower prices using a benchmark, sellers know their prices better and can always find countermoves to recover losses.

Case 2: What you pay determines what you get – Let value speak for price

A company's sourcing department asked one of its major suppliers to lower its price to the market level, which was approximately 20 percent lower than the supplier's normal price. In their request, the customer also implied the supplier would benefit from being introduced to the customer's other business units and departments and could potentially generate a much larger sales volume.

Although the offer looked tempting, the supplier's sales representative checked the previous year's gross margin with this customer and discovered that even a small price cut would end up making this deal unprofitable for them. Moreover, the supplier had always been proud that its quality and value were well above the market average and it had been one of the leading players in the industry for many years. For these two reasons, the supplier decided to stick with the original price level

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and was ready to walk away from the table if the negotiation didn't go well.

The supplier was right about its position in the market. The customer recognized their quality and value and understood it would be difficult to replace them with an equivalent supplier on such short notice. Unable to afford to lose such a valuable supplier, the customer accepted the reasons the supplier gave. After several rounds of negotiation, a price cut of just three percent was implemented.

Lesson learned: Partnerships should be based on value, not price. Sellers with clear value advantages have the bargaining power in negotiations. They can bear the risk of losing an important but unprofitable customer, as they can always find other customers who can contribute to profits. On the other side of the coin, it's equally important for buyers to recognize the value their suppliers create. Buyers have high switching costs with the most valuable suppliers; losing even a single important supplier can sometimes spell disaster. For example, without its clever processors inside, a smartphone is just a fancy piece of plastic.

Case 3: The devil is in the details – Explain your thinking to unleash value

During a negotiation, a customer told its service provider's sales representative, "We think your price for service A is too high. It's above our budget for this year."

The sales representative reached for his documents and took out a table to show the customer. He responded, "This is how we came up with the price. To achieve the outcome of A, it's necessary to carry out steps A1, A2, and A3. In this column, we've listed what you gain from each action. And the column on the right shows you how much each action will cost in order to generate that benefit. Let's discuss which actions you feel can be deprioritized."

After examining the table, the customer realized how valuable each step was. Despite their tight budget, the customer kept most of the key actions in place. The service provider lowered its total price but left with a lighter workload, which translated to lower costs and, therefore, still maintained a healthy margin.

Lesson learned: Every cent should be spent carefully and in the right places. This is true for both buyers and sellers. By sitting together and breaking down the details of the offer, buyers will better understand the offer's value and sellers will better understand buyers' needs and constraints. In this way, a tailored offer can be developed to work in both parties' favors.

These three cases illustrate typical interactions between customers' sourcing and procurement teams and suppliers' sales representatives. As the cases demonstrate, sourcing and procurement teams and sales representatives don't have to be enemies. In fact, they actually share the common goal of creating value as economically as possible.

However, there are several challenges that still need to be resolved:

♦ **For buyers:** Sourcing/procurement KPIs and incentives often focus on saving costs or reducing prices. This unavoidably leads to less attention spent on value creation. A more value-oriented KPI/incentive system and more involvement from business departments in the process would significantly help buyers unleash the value they offer.

♦ **For sellers:** Sales representatives often lack clear guidelines and don't have the skills necessary to fully grasp customers' needs and deliver tailored value messages effectively. A customer who doesn't fully understand the value of the offer will probably not be willing to pay very much for it. ❖