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RAISE YOUR PRICES NOW

Beat the Rush

WHY A RECESSION IS THE RIGHT TIME TO RAISE PRICES

Salespeople are not usually interested in crunching numbers or putting numbers in boxes – except when computing their potential commission checks. In a down economy, especially in a recession, there is a strong tendency to lower prices in order to keep the business coming in. The best approach, however, is to begin raising your prices.

Economics are cyclical. What goes up eventually comes down and what comes down eventually goes back up. Ignoring the inevitability of these cycles can create difficult situations in the future and some of them can be fatal to our businesses.

This is why beginning to raise your prices now is the best approach.

Alan Beaulieu is a familiar name to Vistage members. He is one of the most accurate economic forecasters and he uses leading indicators in a unique way. In late 2009, when unemployment was still rising, consumer spending was low, banks were still failing and the economy was generally ugly, he began ringing the inflation bell. The recovery, he warned, would be accompanied by inflation.

How does the forecast of inflation affect sales?

Let's use a simple analogy. (For you accountants and economists, this is very simple – bear with me!)

Watching the numbers needs to be a proactive, not a reactive, activity

CASE STUDY

Your company has been selling your units (products or services) for $100 which gave you a gross margin of 30% or $30. Your sales have averaged 1,000 units per month. Demand is down because your market is shrinking. Some of your customers have gone out of business and the remaining ones are seeing less demand for their products and services. As a result, sales in your industry are declining for you and for your competitors. Some or even most of your competitors responded to this drop by lowering their prices by 10%. You are now competing with "me-too" products that are selling for $90.

How do you respond? If you're like most leaders, you will drop your prices but not as much. After all, the easiest way to sell is on price and you may have tired of your salespeople complaining that the competition has such a low price. So, let's say you drop your price 5% to $95. Your profit now <u>seems</u> to be $25 and your margin 26%.

But wait, volume is down, remember? So more of your fixed costs must be absorbed by fewer units. To keep our scenario simple, let's say that your costs are 50/50 fixed and variable. That means that the fixed cost per unit is $35 (if gross margin is 30%, costs are 70%; ½ of costs is $35) when you are selling 1,000 units per month. What happens to the fixed-cost-per-unit factor when volume drops? Let's say your volume has dropped 10%.

You can do the math or ask someone who is into finance to work this out. Or, you can just use my number since I already asked a bean counter.

Fixed expenses are $35,000 per month.
Monthly revenue has dropped from $100,000 (1,000 units X $100) to $85,500 (900 units X $95).
Variable expenses are still $35 per unit or $31,500 ($35 X $900).
New profit is $19,000 or 22% which works out to $21 per unit instead of $30.

But, hey, it's still profitable, right? After all, that 8% drop in gross margin still leaves us with some profit. This is when the bean counters get nervous. What if your net-net profits have typically been 5%?

THE PLOT THICKENS

It gets worse as the recovery begins.

Estimates are that inflation in 2010 will be about 5% and in 2011 about 7 – 8%. Since your costs will be rising, you will need to increase your prices to recover those cost increases. 2011 is begin forecasted as the year of greatest growth, so you will want to be positioned to grow as strongly and as profitably as possible.

So, today's selling price of $100 will need to increase to $105 for you to maintain full margin when inflation grows by 5%. How willing will your customers be to pay you the additional 5%?

> *If you have lowered your prices by 5%…*
>
> *… and inflation rises to 5%…*
>
> *…you will need to increase your prices by 12% to make up for the lost profit*

The problem will be that every other vendor the customer uses will be asking for increases as well. This forces the customer to increase their prices and the cycle feeds on itself.

What if you have lowered your price to $95 and now need to move it to $105 to recover your margin? You will now have to ask your customers for an increase of more than 11%! When they are reluctantly ceding 5% to other vendors, why would they give you 11%?

RAISE YOUR PRICES NOW – BEAT THE RUSH

Now is the time to increase, not lower your prices. When the recovery begins and your competitors are scrambling for price increases, you'll be focusing on other issues.

Why would your customer pay you more than they would pay someone else for the same product or service?

They won't.

Our focus as value-added salespeople is to convince the customer that we are not the same. We bring a unique value proposition to the table that is

- Meaningful to the customer
- Assists them in attaining their objectives
- Quantified in customer terms

When they can see these elements, they can understand why you are worth the additional dollars.

> *Why would your customer pay you more than they would someone else with the same product or service?*
>
> *They won't.*

NOW OR LATER

Sooner or later you will need to conduct this quantified cost justification. You can wait until the recovery begins and every other vendor is also trying to raise their prices to your customers. Or, you can begin now to learn and execute the process of developing a qualified and quantified cost justification.

Formal cost justifications are becoming a part of the new normal in sales. Long ago customers stopped asking, “What have you done for me lately?” and replaced it with, “What can you do for me next?” In the new normal, they are asking, “What is the real value to me for doing business with you?”

When the recovery is in full force and your costs begin to rise, is that the time to try and learn how to develop and deliver a quantified cost justification? That’s the approach most companies – many of your competitors included – will be doing. Sooner or later you will need to perfect this skill – why not now?

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value-added selling
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