The Value of Determining a Pricing Strategy

Utilize corporate discipline to manage revenue

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The most critical first step in managing revenue is to develop a strong corporate discipline that clearly defines the pricing strategy of your services. “It all starts with a sale,” is an oft-quoted statement; however, it can all end with careless pricing.

Most support the notion that the goal of a business enterprise is to make a profit. This belief recognizes that marketing is the only management activity that creates revenue, while all others create costs. Effective pricing is the result of market research, recognition of pertinent costs, and having a clear understanding of what the customer values. When a bad deal is struck, it’s bad forever.

Although the pricing of services is complex and has many pieces, the objective of this article is to raise a greater awareness of the critical importance of establishing a corporate strategic pricing discipline—basically paying close attention and not letting old habits gain a foothold. We see too many building service contractors (BSCs) that quote a highly competitive price for their services without thinking through the many factors that can negatively impact the gross margin contribution to overhead and profitability.

Identify Strategic Pricing Objectives

First, it is important to identify who in your organization has the authority to set prices. Are these individuals aware of all direct and indirect costs, including acceptable ranges for desired gross margins?

What is the primary driver that sets the parameters—covering all costs, customer stated value, or the pressure from your competition? Although it’s easy to say all three, usually one is the dominant force that fits your business model and influences the final decision.

Cost-Based Models

There are many cost variables to consider in cost-based models. Among those cost areas are burdened wages, benefit packages, equipment, materials, supervision and management, other indirect costs, marketing expenses, and overhead requirements. Additional variables to consider are the efficiency of the specific cleaning system, productivity rates, required training costs, and managed customer service practices.

One popular but risky approach of this cost model is recognizing the potential of extra billable services that can carry additional profit. In order to take advantage of this, the pricing must be low enough to gain the prospect’s interest, yet high enough to break even. This approach requires a highly skilled individual with a comprehensive knowledge of all direct and indirect costs, and firsthand knowledge of the prospect’s history as it relates to additional work. All of this necessitates strong negotiating skills to create a mutually beneficial service agreement, which can lead to a long-term relationship and consistent extra billing, provided the original position was sound and the BSC stays true to the game plan.

Competition-Based

It may seem naïve of us to identify cost-based pricing in the manner that we did. You may assume, “Of course we’re going to cover costs.” However, we have found two disturbing realities: First, the pricing decision is made by numerous people in differing positions based on past practice; and second, in far too many cases, the true costs to service the new business is actually unknown or miscalculated. Add competitive pressure to this, and you have a perfect storm.

In an industry where it is challenging for many BSCs to identify differentiation, it is common to monitor competitive pricing and respond accordingly. However, from the prospect’s view, if they see little to no difference between offerings, they may choose the lowest price option.

One thing that has been prevalent and very effective in this industry is personal relationships. If there is heavy competition and there are few visible differences in offerings, the personal relationship may get you the contract. However, even this requires a tactical discipline.

Rather than falling into the trap of matching dollar for dollar, consider another way, which involves utilizing key knowledge derived from personal encounters to form a well-thought, customer-focused value proposition. In essence, the value proposition is a statement and positioning that makes a cogent case for a prospect to hire your firm.

Value-Based

When we think of the customer-focused value proposition, it represents the best positioning of a service offering providing the greatest package of benefits. Today the customer is looking for net value, which is the difference between the value proposition and the customer’s perceived value. First, the customer needs to evaluate the stated benefits in the proposition and conclude they are, in fact, acceptable. The greater the acceptance of the perceived net value, the greater the pricing opportunity will be.

Southwest Airlines exhibits a good example of value-based pricing. One of the cornerstones of Southwest’s value proposition to its passengers is that it provides a "fun" travel experience, while its other value-proposition cornerstones are fastest door-to-door travel times and lowest prices.

In the case of Southwest, its customers know the company will deliver. With a carefully positioned value proposition and a high level of perceived value, Southwest can maximize its price strategies, which are further supported by the company’s highly efficient operating costs.

The Fear Barrier

Although very few BSCs will admit to it, a high degree of fear exists among many that recovering new costs for an account renewal or holding back from properly pricing a new prospect will not end well. Actually, it is not whether the fair price is passed on, it is the negative, psychological impact on the organization if it is never tried. Fear can destroy an organization’s ability to deal with setbacks or innovate.

Setting low pricing does not protect an organization; rather, it illustrates a sense of survivorship instead of aggressively pursuing growth opportunities and learning and growing by experiencing positive results. We have seen our share of this, and it should be addressed. The size of an organization has nothing to do with being immune from fear of execution.

The marketplace is returning to increased inflation, and government interference can put pressure on achieving a fair return on investment. The firms that think through their value proposition and are effective in communicating it to end users will be in prime position to win the day.

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