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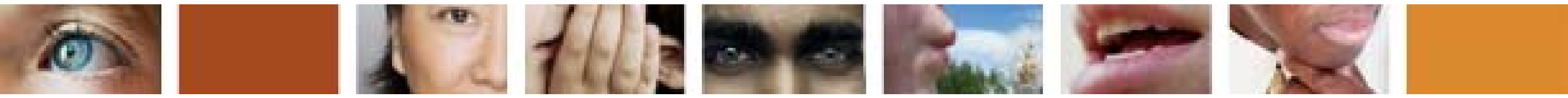

When Clients Demand Price Cuts

Relevant Resources

Article:
Profitability in Professional Services

Article:
What to Say When the Client Says Your Price is Too High

Blog Post:
Discounting and Winston Churchill

"A long-standing client came to us and said our price was too high for a job we quoted. They said one competitor was priced 20% below us, and another 30% below. We're seeing this a lot; word is we're the high-priced firm in this market, and we've lost a few big jobs. It seems to be pretty much a question of price. This business is getting commoditized. Particularly in this economy, we need to seriously consider cutting prices. But our margins are already low."

Have you heard those words lately? Perhaps spoken them? Before you act, make sure you investigate the situation. This article gives you a structured approach to doing so—looking at causes, solutions, and handling discussions.

Causes: What Drives Client Demands

Before you respond to demands for price, it is useful to understand what lies below such demands. Three things drive the vast majority of client demands:

Charles H. Green, 2003

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- **Fear—the simple fear of being taken advantage of.** If clients perceive that someone else is getting a better "deal," they can quickly feel abused, and may react very negatively. Clients who feel abused become very creative about attributing causes—your rates, your profits, your margins, and so forth.
- **Miscommunication—usually around scope and design issues**. The "apples and oranges" problem can arise from many project design issues, including the scope of issues addressed, the leverage of your team, the depth to which issues are explored, timing, and choices about staffing. If the client orders an apple and you price out an apple pie, the client may think you are charging absurd margins on fruit.
- **Quality—misaligned assumptions about quality required**. Many service providers make an implicit assumption about the quality required for a certain kind of work. Often the client doesn't perceive the need for the Cadillac/Mercedes solution—they think a Chevrolet/Volkswagen will do just fine. And often, it will.

When your client demands a price concession, she usually assumes that rates, costs and profit margins are the problem.

Clients demanding price concessions do not present the issue in these neat terms. They simply say, "your price is too high, and you need to cut it." Listen carefully--this **does not mean** that your price is too high--nor that you need to take drastic action. But you'd better investigate what's going on.

Solutions: Fix the Right Problem

When your client demands a price concession, she usually assumes that rates, costs and profit margins are the problem. Few clients (or providers) challenge this assumption. The client thinks she is being taken advantage of by a voracious provider. The provider feels pressured by a callous client playing him off against others. Both then cast the issue in terms of greed and motives, and dig in for tough price negotiations.

But rates and margins are almost never the real problem. The real problems lie in design issues and in misunderstandings. The

Charles H. Green, 2003

When Clients Demand Price Cuts

worst thing to do is negotiate on a total price alone—it makes the client think you've been hiding something, and wonder if he should ask for even more. Too often both parties try to **negotiate price**—when they should be **discussing design**.

To see why rates are not the issue, consider your economic model. The building blocks of a project bid boil down to:

- The firm's costs—i.e. compensation levels
- Rates—a function of cost, utilization and margins
- Project design scope
- Project design leverage
- Project design quality

Make sure you spend enough time understanding and empathizing with the client's concerns.

Now ask yourself—how does my competitor's model differ from mine, and what is he cutting to get his prices 30% below mine?

Compensation costs vary hardly at all. The salary market is extremely competitive. Nor do firms vary much on billing rates, utilization and models. None of it is enough to explain a competitor's 30% discount.

That leaves two explanations: either the projects being discussed are just not comparable—or your competitor will lose money on this bid. The discussion you need to have with your client explores both options—in that order.

Handling the Pricing Discussion

Above all, clients want to know they are being treated fairly. Doing so starts with a fair price for work done, and the willingness to be open about how you arrive at that price. Very few clients actually want to pay an unfair price to a provider who has dealt fairly with them. Here's how to have that discussion.

1. Commit to resolution. Make sure you spend enough time understanding and empathizing with the client's concerns. Say you're committed to finding a mutually acceptable resolution—and mean it.
2. Suggest a series of price drivers--from scope and quality concerns to economic drivers—and commit to exploring each in turn.
   a. **Start** with **scope and design** issues. Ask the client to compare in detail your

Charles H. Green, 2003

When Clients Demand Price Cuts

project design with the competitor's. That means nailing down modules, scope of research, staffing levels—everything that might be different. Then compare. More than half the time, discussion will stop right here. Most fears are simply misunderstandings of design.

b. Move on to **quality** issues. Determine whether quality in your proposal is higher than that proposed by a competitor. If so, then ask whether the client is willing to pay for extra quality—or not. If the answer is "not," be ready to scale back or walk. Your "standards" may be costing you business.

Price negotiations don't have to be about power and control; trust and openness go a very long way.

c. If the issue is not yet settled, then put your structural economic cards on the table. Tell the client your billing rate structure, base compensation structure, leverage model and utilization rates. Explain why these numbers add up to a fair profit model for you, and why they probably don't vary much by competitor—certainly not 30%.

3. Now you can face the competitor 30% discount head on. Confirm the project design is comparable. Say to the client, "I believe their economic model is similar to ours—and we could not sustain a 30% discount. How long do you believe you will continue to get that discount? And are you willing to switch again if and when they move to sustainable prices?"

If the client would be willing to switch yet again to find yet another discounter, then you should probably walk away and find a relationship buyer. If so, walk away smiling—your competitor just lost money, and you didn't.

Price negotiations don't have to be about power and control; trust and openness go a very long way. Most clients are happy to pay a fair price to a provider they trust. Just give them the information with which to trust you.

Should you ever cut price? Yes, in two cases. The first is for a volume discount, including existing-client discounts. In these situations, your cost of sales is genuinely reduced; that's real money, and can be shared.

Charles H. Green, 2003

When Clients Demand Price Cuts

The second reason is to buy your way into a new business or client. Don't do it lightly. Eventually you will have to raise rates to sustainable levels; and a client who switched to you on price is prone to switching again.

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