Trakia Journal of Sciences, Vol. 9, Suppl. 2, pp 185-193, 2011

Available online at:
http://www.uni-sz.bg

ISSN 1313-7069 (print)
ISSN 1313-3551 (online)

CUSTOMER NEGOTIATION

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ABSTRACT

This paper focused on four issues that arise when salespeople implement pricing strategy. First, we described the long-term problems that companies create when they permit customers to negotiate prices, and we explained how fixed-price policies can limit the damage. Managers often believe that fixed-price policies will not work in their markets. However, once they understand that fixed-price policies need not be one-price policies, most companies can develop segmented pricing policies to charge different prices without undermining the relationship between price and value. Second, we developed strategies for selling to price buyers, loyal buyers, and value buyers. Finally, we presented a formal, analytical model for preparing competitive bids and discussed the problems involved.

In the end, the best tactics can go amiss, and sellers can guess wrong concerning the buyer's intentions and ability to place an order. It is neither possible nor even desirable to win every sale. Still, sellers and buyers should strive to develop tmsting relationships guided by positive-sum negotiations. Unfortunately, many buyers focus solely on price, and many sellers use price for short-term gains at the expense of close relationships with buyers. The salesperson's job is not to close every sale, but to selectively participate in those sales that contribute to the company's long-term profitability.

Key **words:** negotiation, strategy, price, method

It can be said that pricing is the "moment of truth" in marketing. That moment occurs in the offices of purchasing agents and field salespeople, far removed from the marketing departments and executive suites where strategies are created. Consequently, even well-conceived pricing strategies frequently fail due to ineffective implementation. To capture value in pricing, sales managers and salespeople must learn to assess the negotiating positions that customers employ and to respond appropriately. In this paper we will:

1. Analyze and compare the effects of fixed versus negotiable price policies
2. Discuss the appropriate negotiation strategy for there types of buyers
3. Present an analytical method for preparing closed competitive bids when you have just one chance to make the right price offer

Negotiated Versus Fixed-Price Policies

During resent years, an ever larger share of prices have become negotiable. Companies that for decades enjoyed leading market shares in mainframe computers, office equipment, or pharmaceutical and telecommunications services are today negotiating discounts to retain sales. Hospitals, law firms, and maintenance companies are negotiating prices for services. Even in consumer markets, substantial discounts are negotiable for high-quality blades products, hotel rooms, annual fees on credit cards, and general merchandise available at local home centers. It seems as though the price of anything and everything is now open to discussion.

Reasons for negotiating price

In many cases price negotiations are both desirable and necessary. When customers purchase unique products (for example, new construction, a telecommunications satellite, or a new home), negotiable prices permit the seller to price based on the buyer's ability and willingness to pay. Moreover, when customers purchase infrequently, they are unlikely to develop the knowledge and expertise to determine the prices that other customers pay. In industries with standardized, frequently purchased products, however, price negotiations undermine a firm's ability to capture the value of its products. Unfortunately, it is in these industries that price negotiation appears to be growing most rapidly.

Many markets - from mainframe computers, to home appliances, to legal services - are now experiencing the symptoms of maturity: slower growth, reduced differentiation and more knowledgeable, value-conscious buyers. Rather than adjust their price policies and margin goals to more accurately reflect the new competitive enviromnent, many companies simply begin negotiating discounts on an individual account basis. Customers learn that the price they pay is related more to negotiating power and ability than to value received. Consequently, selling moves from a cooperative process of finding the best solution for the customer to an adversarial process of dividing the gains. Companies is this situation find that even when they create products of superior value, customers are unwilling to pay a price that reflects that value.

Moreover, negotiable price policies teach salespeople to use price as a tool for closing sales rather than to raise the customers' willingness to pay by selling value. To make matters worse, many companies that negotiate prices actually encourage salespeople to sell on price by rewarding them for achieving sales volume rather than profitability.

Managers must recognize that changes in customer value and competitive conditions require ongoing modifications of fixed-price structures to maintain legitimacy in the eyes of customers. Evaluating pricing structures on a continuing basis ensures that companies capture the unique values of individual customer segments and the volume opportunities they represent. Unfortunately, managers unable or unwilling to capture this value cede control over pricing and ultimately over the strategic direction of their businesses. Companies that hope to maintain win-win relationships with their customers by providing exceptional value have little choice but to establish and maintain fixed-price policies that realistically reflect market conditions.

Before you conclude that a fixed-price policy cannot work in your industry, recognize that such a policy need not be a one-price policy. You can and should provide fixed discounts for volume, long-term contracts, and bundled purchases. You can also maintain different margins for different products in your line and for objective customer segments (for example, senior citizens). A fixed-price policy means simply that the price for any particular customer segment is nonnegotiable. If a customer needs a lower price, he or she must be prepared to give up something to qualify for a better discount.

Undoing the damage

For many companies, the problem becomes how to work their way back toward a fixed, value-based pricing policy when customers have come to expect that every price is negotiable. The following guidelines will help you establish a fixed-price policy where account-level negotiation has previously proliferated.

1. Price must accurately reflect the unique value of products to different customer segments. If they don't, you must further segment and increase the standard (nonnegotiable) discounts for the most price-sensitive customers. If some price-sensitive customers can't be segmented, then walk away from the business to protect the integrity of your prices to other more profitable segments.
2. Salespeople must be educated on how to sell product value and be appropriately compensated to do so.
3. Use the switch to a nonnegotiable pricing strategy as a promotional tool. Customers should perceive the fixed-price policy as a fair change for both the buyer and the seller, not as a price increase. This is done most easily by introducing fixed prices as new products or models are launched.
4. Use nonprice "closers" as an alternative to price cuts. Added value, in the form of free supplies, extra training, or new services, can help salespeople close sales to value-sensitive customers without so visibly undermining the price level. Make sure you account for the costs of these on a per account basis, just as you would a lower price. Otherwise accounts may appear profitable that actually are not.

Understanding the buying center

Before you can formulate effective negotiation strategy, you must first understand who the buyer is and his or her role within the buying center of the corporation.Sales to organizations is far more complex than sales to individuals because each member of the buying center evaluates alternative products and suppliers based on unique criteria. Buying centers generally consist of individuals who fulfill the following roles:

1. *Initiators* start the purchasing process. Routing product purchases may be initiated by front-line production workers or supply personnel. In complex purchases, initiators might come front engineering, research and development, or elsewhere in the organization.
2. *User* use the product or service. Although easy to identify, users may not have a great deal of power in the purchasing process.
3. *Buyers* have the formal responsibility for purchasing products and services. Although purchasing agents often fulfill this traditional role, it is not unusual to have other members of the organization perform this task especially in small organizations or when purchasing capital equipment.
4. *Gatekeepers* control the flow of information and external contact with the supply firms and are often considered experts in a particular product area. Often this role is fulfilled by a nondecision maker who can only influence the decision process. A common mistake is to assume that the gatekeeper is the decision maker.
5. *Deciders* possess the final authority to select the vendor who will supply the product. The real decision maker is often shielded by a host of individuals filling other roles.

A common mistake that salespeople make is concentrating on a limited number of people, thus underestimating the impact that other members have on the final decision. A request from engineering might initiate an evaluation based solely on performance and quality; the decision may then move to purchasing, where product attributes are secondary to price and adjust their negotiation strategy accordingly. Selling differentiating attributes to a purchasing agent who does not value them is a useless exercise.

Negotiation Strategies

Effective negotiators must understand the various buying behaviors associated with different types of buyers and their individual purchasing agendas. These behaviors are a function of how buyers value differentiating attributes of products and their willingness to pay for them. Although suppliers often concentrate on selling differentiation value, a buyer's willingness to pay may be based on other criteria. Successful sellers must adapt their negotiation strategies accordingly. In this section, we describe sales negotiation strategies for dealing with price buyers, loyal buyers, and value buyers. Convenience buyers are excluded because they are not concerned with value or price, but rarely availability.

Negotiating with price buyers

Price buyers are usually larger companies and government agencies with the resources and incentives to qualify multiple vendors.

There are several strategies for negotiating with price buyers. The first and certainly most difficult option is to refocus their attention on product value and to raise their willingness to pay by proving that added value is cost justified. This is usually not possible for one salesperson to achieve alone. It requires a commitment by the selling company to invest resources to beguile customers into compromising their pure price orientation.

Although your long-term objective may be to change price-driven purchasing behavior, many price buyers will never change. In this case, sellers must follow a strategy of *selective participation,* carefully evaluating the short-term profitability and long-term implications of these transactions and accepting them only when they provide incremental contribution and do not undermine more profitable business.

Companies often invest resources to serve price buyers in the vain belief that someday their efforts will prove profitable. Resist the temptation to negotiate for a price buyer's business in anticipation of future profits-they rarely materialize. If you can't participate in their business profitably, acknowledge the futility and walk away. Fortunately, the long-term consequences of walking away from a price buyer's business are minimal. Since, by definition, price buyers react to low prices, you can always go back and participate in their business later by offering a low price *when it is strategically prudent and profitable to so!* More important, selective participation sends a significant signal to your other customers that you're nit going to invest resources where there is no payback. Sales, service, and support personnel focus on servicing value buyers and loyal buyers, since profits are more certain.

The prospect of walking away from price buyers is terrifying to many marketers since price buyers are often their largest customers. By selling to large customers, many firms are focusing on the toughest negotiators with the toughest price buyers and are losing the opportunity to capture additional profits from more profitable segments.

Since fixed-cost structures of manufacturing operations are often justified by the volume that large customers represent, it is difficult to totally walk away from all price buyers' business. Fortunately, because large customers often negotiate with multiple suppliers, marketers can look for favorable opportunities for selective participation. When a bidding war occurs, it is best to get in the end of the process, when sellers are less likely to be emotionally committed to winning the battle. When it becomes necessary to bid a lower price, it is just as easy to say to the buyer, "When you're ready to place the purchase order, I'll give you my best price." This limits the damage that a buyer can do by "shopping" the price with competitors and allows the salesperson to take the order "off the street" and thus limit the likelihood that other competitors are considered.

A similar option is the "five minute price" tactic. Here, the low price is not put in writing and is in effect for only a short time. Without documentation, the price buyer has nothing to show competitors to elicit their response. If the seller is the preferred competitor, the buyer may recognize that such a low price might not be offered again and must decide if there is any value in continuing the negotiation process. The risk in employing such a strategy is that customers may determine that the seller is bluffing and ignore the tactic entirely. If this is likely, avoid this tactic.

Negotiating with loyal buyers

Loyal buyers are the polar opposite of price buyers. They value consistent product quality and performance, and they rely on trusted suppliers to continue providing it. Their ongoing loyalty is driven fundamentally by the risk and uncertainty associated with untested suppliers. The critical implications of inadequate performance outweigh for the loyal buyer the benefit of lower price in the short term. Here, confidence in "tried and true" existing solutions from proven vendors sustains ongoing relationships.

Stress the impact of inferior product performance on the buyer's firm, the sunk cost of previous investments, and compatibility with future requirements. Utilize unique price and quality metrics to make comparisons between and among vendors more difficult. Above all, make clear your commitment to meeting customers' current and future needs and to eliminate their incentive to look for alternative solutions. Invest sales and management time to thoroughly understand loyal buyers' sources of value. Over time you will be better positioned to react to their needs and reinforce your position as a trusted vendor.

In contrast to adversarial negotiations with price buyers, negotiations with loyal buyers are more amiable and focus on solutions that satisfy both buyer and supplier business goals. Less tangible, more augmented features such as technical expertise, reliability of service, and dedication to customer satisfaction have measurable value in the evaluation process. Although satisfactory past performance is fundamental, a clear indication of future commitment is also critical.

Although the loyal segment may be large during the growth stage, it invariably shrinks in maturity, as more competitors develop good reputations and buyers become knowledgeable repeat purchasers. The loyal segment also contracts during recessions, when even otherwise loyal buyers may be scrambling to cut costs. Thus, a classic dilemma arises: Should the company cut its prices and service levels to focus on loyal customers who are migrating to the value segment, or should it maintain its prices and services to focus on the customers who remain loyal? The answer is both. By unbundling the costs of service and by designing equally reliable but cheaper products, companies can leverage the reputation they developed while buyers were loyal and continue capturing the business of those buyers as they become more value conscious.

Although obtaining business from loyal buyers justifies the investment of a firm's resources, when negotiating with loyal customers already beholden to your competitors the theory of selective participation is once again applicable. By definition, these are loyal customers and the likelihood of them changing suppliers could be extremely low. Intelligent marketers must evaluate their accounts carefully, selecting only those customers who are likely to switch and yield profitable opportunities.

Negotiating with value buyers

Value buyers represent the largest group of buyers in most markets. They seek neither the highest quality nor the cheapest price. Instead, they make their purchase decisions by careftilly weighing attributes and analyzing trade-offs, ultimately purchasing the product offering the highest utility per unit price. Unlike price buyers who focus on cost, value buyers both recognize and cost justify the added utility available from more expensive options. This segment, therefore, represents an exceptional opportunity for profits to the firm that can effectively communicate superior value. The difficult challenge with these customers is to retain their business over time since they are constantly reevaluating their alternatives.

The decision to invest resources and develop long-time relationships with value buyers is a difficult one to make. Unlike loyal buyers, who clearly justify investment, or price buyers, whose limited payback is readily apparent, value buyers have no predetermined alliances. Although they may indeed repeatedly purchase your competitively-priced and well-performing product for a while, apparent loyalty quickly erodes when competitors' products imitate your product's features. Given the potential of a short-term relationship, marketers must once again use a strategy of selective participation and carefully analyze whether doing business with this segments the most effective allocation of. the firm's resources. When negotiating with value buyers your objective is to capture the maximum value of your differentiation on each individual sale.

Successful implementation of a value-based pricing strategy depends upon a salesperson's ability to distinguish between situations in which a lower price is required, and situations in which the customer needs to be better educated on the value of the product. Salespeople must be trained to understand how customers value their products and to use value-based selling techniques and negotiating skills to communicate that value to customers. Finally, salespeople must master techniques used to reduce the damage done when price negotiations do occur.

Salespeople must always keep their emotions out of the negotiations process and must keep sight of their objective of closing the deal. The problem inherent in adopting a "win at all costs" strategy in competitive pricing situations. The same holds true for customer negotiations. It is important for salespeople to maintain a high level of professionalism during the negotiations process, even if the buyer insists on adopting adversarial tactics. Negotiation is not a war to win, but a process to complete to the mutual satisfaction of all those involved.

When conflicts arise, it is important that both parties understand the basis of the conflict, that is, which issues are negotiable and which are not. Fighting over irreconcilable differences clouds the process and inhibits an outcome favorable to both parties. Each side begins to move away from an amicable solution, becoming entrenched in opposing positions from which resolution is virtually impossible. Participants must be willing to compromise in order to come to a satisfactory solution. Suppliers must recognize that cost control is fundamental to customers' competitive pricing, and customers must understand that suppliers are in business to make a profit. Once both parties adopt the objective of "closing the deal" and of being satisfied with the results, the process can focus on how to achieve those objectives.

Avoiding the price trap

Managers often instruct salespeople to sell on quality, non on price. They are missing the point. Product quality and added features hold no significance until they are valued by customers. Although loyal buyers will buy features, value buyers must be convinced that those features are worth the cost.

Several techniques support selling product value. First, a cost-benefit analysis, such as economic value analysis, provides customers with a clear understanding of how your product can save them money or add value to their products. During the sales process, a formal proposal detailing value analysis should be provided. Many marketers avoid this technique of the effort required and the risk of documenting specific and productivity enhancements. This risk can be minimized if conservative approaches are used in the analysis and if effort is made, up front, to have the critical data verified by the customer. Still, one must sell the value to the customer and convince the buying firm that it must pay for value. The following two techniques have been proven to support selling product value.

Subtraction Technique

This technique involves removing product or service attributed from the original package to "justify" the lower price requested by customers. This technique helps distinguish among buyers who are trying to extract a price concession and buyers who do not value specific product attributes. It forces customers to recognize the value of attributes unavailable at the lower price, while refocusing their attention away from the gain of a lower price to the loss of differentiating product attributes. A variant of this technique involves stressing the penalties of doing without your product. This method requires extensive knowledge of competitive products. When used property, this technique provides salespeople with the opportunity to discuss the "unique benefit" of their products.

Division Technique

This technique breaks down the cost of the product into smaller units relative to the customer's process. This technique takes advantage of the end-benefit effect and forces the customer to recognize that the price difference is insignificant relative to the risk of failure and other costs of doing business.

Preparing Competitive Bids

Competitive bidding is an alternative to negotiation for price buyers. The buyer develops the specifications and asks for prices. In some cases, such as sales to government, there is no opportunity to sell value and the business goes to the lowest bidder. In other cases, you may be able to talk with the buyers added determine what added features might make your bid more attractive despite a higher price. Pricing an order or project for a competitive bid is the ultimate price-buyer situation. It often involves a huge investment on the part of the supplier hoping that its bid will win a job. Because competitive bidding is used most often for very large projects, winning or losing can have an exceptional impact on a company's financial health and ultimate survival.

In complex bid situations, every aspect of pricing-costs, price sensitivity, and competition - is uncertain to some degree. No firm is ever entirely certain what each input will be and how it should impact the final pricing strategy. In some cases, the degree of uncertainty is low enough to allow informal judgments to be made. Many companies in industries such as involved in complex, long-time bid situations. Informal judgments do not provide these companies with adequate solutions for developing pricing strategy, which makes pricing in competitive bidding situations particularly risky. Thus companies placing competitive bids are especially willing to use more quantitative techniques to ensure that they make the best possible decisions.

Quantitative analysis

Quantitative analysis brings no new data to the bidding problem. Instead, it helps managers examine the implications of the data. Attempts to make unassisted pricing judgments when facing multiple sources of uncertainty are likely to prove frustrating if not impossible since they require managers to think of more factors simultaneously than is humanly possible. Consequently, managers often disregard data that could improve their decisions. Quantitative bidding analysis enables managers to think about the problem in more tractable pieces, which can then be combined and reviewed. It helps to pinpoint sources of disagreement and to focus on them in discussion. Further, it forces the manager to go other sources of judgment, and it facilitates evaluating risk-return trade-offs. Finally, since quantitative analysis requires documenting the decision, it helps managers learn from past experiences.

Although simple in theory, competitive bidding is quite challenging in practice, since neither the profit contribution nor the probability of success is ever obvious. The incremental cost of winning a job varies significantly depending on the amount of other business that a company has already won. If a company has excess capacity, the contribution from wining a bid may be quite large since many costs will be sunk. However, if completing a job requires added capacity or costly delays in other jobs, incremental costs will be high and the profit contribution relatively low. Similarly, a bidder should consider the opportunity cost of committing capacity too early. Bidding low enough to win many early bids may preclude bidding on more lucrative jobs later on.

Even more difficult is assigning the probability that a given bid will be successful. Typically, assigning probabilities is a blend of research and judgment. The more a company knows about past bidding behavior in the industry and the current bidding situation, the better are its chances of producing a profitable winning bid. There are two methods estimating a bid's probability of success: The average opponent approach and the specific opponent approach. The choice between them depends on the amount of information available.

Probability of success

Average Opponent Approach The average opponent approach is used to establish probability of success when a company has little knowledge about or past experience bidding against any specific competitors. The approach treats all competitors as essentially the same in the aggressiveness of their bidding. The company using this approach begins with an analysis of past bidding behavior. First, it collects as much information as possible about bids on past jobs that were similar to the current job. Then, to facilitate comparison of bids from different jobs, it expresses each bid as a ratio: the bid price divided by the firm's own estimated cost of the job. If the company estimates the cost of a job as $5 million, a bid of S6 million is expressed as ($6/ $5) and a loss-leader bid of $4,5 million as 0,95 ($4,5/$5). After doing this for as many jobs as possible, the company calculates the percentage of times that competitors' bids exceeded any particular value of the ratio.

If management has no other information, the company could use these historical bid frequencies as the probabilities that it would underbid any single competitor on a single bid. For any particular bid ratio, *R,* we will label the probability (P) of underbidding any single competitor as P(R), that is, PxR. In practice, management usually has additional information about differences between the current bid and previous bids, which it uses to make subjective adjustments to the historical bid frequencies before adopting them as current bid probabilities. For example, if the industry is operating at higher capacity levels now that in the past, management assigns subjective probabilities somewhat higher than the historical bid frequencies. On the other hand, if this job is particularly attractive because of the additional business that winning it might produce in the future, management might expect competitors to bid lower than usual. In the latter case, management assigns subjective probabilities somewhat lower than the historical bid frequencies.

To calculate the probability of winning a particular job, management must next consider the number of bidding competitors. The more bidding competitors, the lower the probability that any one bid will win the job. Since the average opponent approach assumers that management cannot distinguish among its competitors, the probability of underbidding each of them is the same. Consequently, if the numbers is *N,* the probability of winning the job with any particular bid ratio is Pwin(R); then

$$\text{Pwin (R)} = \text{P(R)}^{N}$$

If the historical bid frequencies shown above equal the subjective probabilities of underbidding a competitor, the probability of winning against two average competitors with a bid ratio of 1,1 is:

$$\text{Pwin (1,1)} = 0{,}80^{\mathbf{2}} = 0{,}64 \text{ или } 64\%$$

Exhibit illustrates the probability of winning for each bid ratio, given two, four, or six opponents.

Bidders often do not know how many competitors they will be bidding against, which adds further uncertainty to the problem. Management must formulate subjective probabilities for the number of expected opponents. It then uses those subjective probabilities to weight different calculations of Pwin that assume different numbers of competitors. For example, if management's subjective probabilities for the number of other bidders are:

2 other bidders 0,5
3 other bidders 0,4
4 other bidders 0,1

the probability of winning with a bid ratio of 1,1 in the example given above is as follows:

$$\text{Pwin (1,1)} = (0{,}5 \times 0{,}80^{2}) + (0{,}4 \times 0{,}80^{3}) + (0{,}l\times 0{,}80^{4}) = 0{,}565 \text{ или } 56{,}5\%$$

Specific Opponent Approach The average opponent approach to establishing probability of success is appropriate only when a company knows little about its individual competitors. Usually, however, a company does know who its competitive bidders are and their different motivations. When bidding for government contracts, for example, potential bidders must state an intention to bid some months before the bids are actually due; the list of those firms is available to all competitors. When bidding for specialized construction projects, such as large hydro-electric power plants, the number of qualified bidders is so small that bidding is always against the same three or four competitors. When a company knows who the competitors will be and their prior bidding behavior, the *specific opponent approach* can help them make more successful bids.

The specific opponent approach begins much like the average opponent approach, with an analysis of historical bidding behavior of the competitors. The bidding behavior of each competitor, however, is separately analyzed. For example, if both opponent A and opponent B are frequent bidders, a company using this approach would separate them from other competitors when attempting to estimate the probabilities of underbidding them. For each value of the bid ratio, R, it would calculate the number of times each specific competitor's bid exceeded R. If other bidders, called *peripheral opponents,* are also bidding, they are treated as a separate group using the average opponent approach.

As with the average opponent approach, the company uses any information about differences between this bid and previous bids to adjust the historical frequencies before using them as the probabilities of underbidding competitors on the current job. In would adjust the historical frequencies for each specific opponent based on whatever information it has about that company. For example, if opponent B recently installed a new president, who announced corporate goals including a substantial increase in market share, one might expect that the probability of B's bid exceeding any given bid ratio would now be lower. Similarly, if opponent A recently won a large contrast committing much of its capacity, one might expect the probability that A's bid would exceed any given bid ratio would now be higher.

The probability of winning the job, Pwin, is the probability of underbidding the specific opponents and the peripheral opponents. Let PA(R) and PB(R) be the probability of underbidding specific opponents A and B, respectively, and let PO(R) be the probability of underbidding one of the peripheral opponents for any particular bid ratio R. If the current job involves bidding against opponents A and B in addition to N peripheral opponents, the probability of winning with any given bid ratio R is as follows.

$$Pwin(R) = Pa(R).P_B(R).P_O(R)^N$$

If the historical bid frequencies are used without adjustment as the probabilities of underbidding the opponents, the probability of winning a job with a bid ratio of 1,2 when bidding against opponents A and B and two peripheral opponents is as follows.

$$Pwin(1,2) = 0,55.\ 0,60.\ 0,40^{\mathbf{2}} = 0,53 \text{ или } 5,3\%$$

In management is uncertain whether opponents A or B will bid, it weights the bids of the specific opponents by the subjective probability that each one would bid.If the company is uncertain about the number of peripheral opponents who would bid, it weights the calculation of underbidding exactly as shown for the average opponent approach.

The winner's curse

Competitive bidding is notorious for winning bidders to lose money. In fact, research shows that even bidders who use sophisticated models and formalized techniques often lose money. The reason is the winner's curse. To understand the curse, imagine first that you are one of two bidders and you win a bid with the lower price. You will probably be quite happy. Now imagine that you are one of ten bidders and you believe that your competitors are sophisticated businesspeople who know how to bid a job. Again you win. Are you still as happy? What does it mean that you bid below nine other knowledgeable bidders? Perhaps it means that you were willing to take less profit on the job. On the other hand, it could also mean that you underestimated the cost to complete the work.

The more bidders there are, the more likely you will lose money on every job you win, even if on average you estimate costs correctly and both you and your competitors set bids that include a reasonable margin of profit. The reason: The bids you wine are not a random sample of the bids you make. You are much more likely to win jobs for which you have underestimated your costs and are unlikely to win those for which you have overestimated your cost. Consequently, the expected profitability of a job, conditional on the fact that you have won it, is much less that the expected profitability before winning. The difference between the conditional and unconditional probabilities increases with the number of competitors against whom you must bid.

The only solution to this is, in effect, to formalize the principle of “selective participation” described above. You do that by adding a “fudge factor” to each bid to reflect an estimate of how much you are likely to have underestimated your costs if you actually win a bid. Needless to say, adding this factor will reduce the number of bids you win, but it will ensure that you won’t ultimately regret having won them.

This paper focused on four issues that arise when salespeople implement pricing strategy. First, we described the long-term problems that companies create when they permit customers to negotiate prices, and we explained how fixed-price policies can limit the damage. Managers often believe that fixed-price policies will not work in their markets. However, once they understand that fixed-price policies need not be one-price policies, most companies can develop segmented pricing policies to charge different prices without undermining the relationship between price and value. Second, we developed strategies for selling to price buyers, loyal buyers, and value buyers. Finally, we presented a formal, analytical model for preparing competitive bids and discussed the problems involved.

In the end, the best tactics can go amiss, and sellers can guess wrong concerning the buyer’s intentions and ability to place an order. It is neither possible nor even desirable to win every sale. Still, sellers and buyers should strive to develop trusting relationships guided by positive-sum negotiations. Unfortunately, many buyers focus solely on price, and many sellers use price for short-term gains at the expense of close relationships with buyers. The salesperson’s job is not to close every sale, but to selectively participate in those sales that contribute to the company’s long-term profitability.

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