

## **Managing in a Downturn – *Shaping your business for the future.***

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***To shape our businesses for the future we must embark upon a strategy, which focuses upon simultaneous activity in protecting volumes, reducing costs and increasing prices.***

Some time ago, two excellent articles appeared in the financial press. Both articles stressed the need for cost cutting to protect margins in the current economic climate. I have little argument with the articles especially as both of them urged caution against ‘knee jerk’ cost cutting and suggested ways in which cost cuts should be made with the long term in mind.

Both articles went to great lengths to stress that the objective of any cost cutting programme should have the purpose of ensuring that a business COMES out of a downturn in a better shape than it was when it went into it.

Good stuff, fundamental you might think, but I fear that adopting a strategy of cost cutting in isolation to two other essential and simultaneous activities is, in itself, A short term ‘knee jerk’ reaction to margin pressure AND DIFFICULT MARKETS.

There are three leverages upon our margins; volume, cost and price and to adopt any policy or strategy for ***managing in a downturn*** which does not encompass specific action on all three of these leverages can not possibly shape a business for the future.

Let us look firstly at the facts. What truly are the effects of a volume increase, a cost decrease and a price increase on the net profit. A 10% increase in sales volumes is required to produce a 50% increase in the bottom line. A 12.5% REDUCTION is required in fixed costs to have the same impact but only a 5% increase in price is required.

It is obvious that the three leverages are disproportionate to each other as it is also obvious that the greatest leverage on the bottom line is the price change.

A 10% increase in volume produces a 50% increase of the bottom line, a leverage of 1:5. a 12.5% reduction of the fixed costs produces a 50% increase of the bottom line, a leverage of 1:4. but only a 5% increase of the price is required to produce a 50% increase of the bottom line, a leverage of 1:10.

Not long after the publication of the two articles, which I refer to, the CBI published a manufacturing industry report which indicated that small and medium sized UK manufacturers have undergone the biggest drop in business confidence since January 1999. However, from that report, the most significant fact was almost ‘tucked away’. None of the surveyed firms had felt able to increase their prices for the past eighteen months despite the fact that their input costs over the same period had increased by 21%!

It is evident from reading the financial press that many businesses are being threatened by typical downturn signals – customers are destocking, prices are being pushed downwards, and it is not just a downturn that is pushing companies against the wall, but also the ongoing strength of sterling, and the falling price of imports. It is vital that businesses take strategic action sooner rather than later to beat this triple whammy.

In our work all over the world with industrial, manufacturing and service companies, getting better prices and getting regular price increases through to the market is always a very topical and emotional subject especially with many sales forces. Much emotional and irrational argument is generated and the consequences of even thinking about increasing prices are seen as an absolute sure way of losing volumes, market share and customers, particularly when markets are facing a downturn.

Nevertheless the absolute fact remains that finding ways of getting better prices and getting price increases through is not only essential for business survival but also is clearly possible As all of our clients have proved. It is in the skill area of 'price management' in all of its aspects that the master sales person stands above their peers and this can be achieved even when you might think that the market cannot handle it.

The key point, which I make, is that whilst reducing costs and protecting volume is essential for managing a downturn, we must primarily focus upon price management to shape our business for the future. The strategic need for managing in a downturn is a simultaneous activity in all three of the leverage factors.

Over the last twelve months as well as working in the UK economy our team has been working in economies that have clearly been in 'downturn' status for some time now. From the many sales, purchasing and profit improvement workshops I have held, I have selected just a few of the recurring points designed to help clients survive the downturn facing many markets. By implementing one or two of the ideas that follow you will come out of a downturn not only stronger and leaner but also in a position that will enable continued growth.

### ***Increasing top line sales in a downturn – MAINTAINING CUSTOMERS***

Developing the business we have, rather than chasing after new customers, is always at the top of the list in downturn strategies, but at the same time as keeping the client it is paramount to increase the profitability of that client. It is essential to get 'very' close to your key customers. It certainly was no surprise to me to read in the ***Winning Business*** report ***The Future of Selling*** that client relationships, customer retention and customer satisfaction are now seen as clear priorities in today's markets.

In particular it is vital to ensure that your 'service differentiators' are of real value to your key customers. Shape your service and care disciplines around each individual business. Macro differentiation has little customer care value only micro differentiation adds real value. Locking customers in through exemplary service factors is a paramount activity

Focus on customers who provide clear and sure growth potential. I asked a group of Senior Sales Managers recently to choose the three customers with whom they would wish to rely upon in the future. Not one of them used growth potential as a criteria for their selection, all chose volume as the benchmark. It is unfortunate that it could be clearly demonstrated that every one of those volume customers were solely dependant upon heavily declining markets!

Managing and controlling distributors and stockists is also a frequent 'top of the action list'. With one of our major clients a review of their distributor network proved that many were disloyal and actively involved in switch selling away. None were found to be carrying adequate stocks to support market needs and few had the technical competence to protect their market.

If you have a 'distributor network' ensure that the network is well and properly managed. Put in place agreements, which prevent cross or switch selling by your distributors. Think carefully about the optimum number of distributors because you need to prevent territorial or application competition between your distributors you are the eventual loser of such activity. Raise your loyalty expectations even in a downturn.

### ***Reduce your costs in a downturn – TIGHTENING YOUR BUSINESS***

Work on all of your costs not just your fixed costs. Supply Chain Management is not just a piece of business jargon it is a real time activity and a vital operation that every company needs to get involved in. Why should you have to suffer input costs higher than they need be because of your supplier's inefficiencies or wasteful processes? How easy to supply to are you; do you put unnecessary restrictions or conditions upon your supply lines that in effect increase your prices? When did you last check the specifications and tolerances that you insist upon? Are you over engineering?

Breaking the 'cost plus' mentality is another frequent action point; what on earth have costs got to do with prices? Ok, cost plus produces a figure below which you will not sell (unless of course you are heavily into discounting) but face up to the fact that cost plus can produce your minimum price. Cost plus can never produce for you the maximum price that the market will pay.

***Get better prices and get price increases through regularly and quickly even in a downturn – KEEP YOUR BUSINESS PROFITABLE***

Perhaps the most productive of all of our sessions with our clients is our product mapping session. The essence of product mapping is market related pricing.

There is nothing new in market related pricing. But my experience tells me that whilst many businesses accept the need to relate their prices to the market they struggle to find an acceptable and reliable means of determining precisely where they should price up and where it is necessary to price down.

This dilemma often leads companies to resort to discounting as a means of reaching the price at which they can secure the business and then attempting to disguise the practise of discounting by calling it market related pricing. To consider discounting as market related pricing is to display a myopic view of both subjects. Discounting is also frighteningly common when markets are tough.

**PRODUCT MAPPING MODEL (BELOW)**



Utilising the model above we aim to seek areas in the market place where our clients can and should be getting better prices certainly prices, which are at a premium to standard or cost, plus prices.

But we also acknowledge the need in some areas of our client’s market to be exceptionally competitive; by using the same model we can also identify these areas. The key aim is to ensure that we are pricing appropriately for specific areas of the market.

The three clear areas where premium prices are possible are in the ‘high’ segments of the model. The areas where exceptionally competitive pricing is required are in the ‘low’ segments of the model. Achieving a balance of these customers is vital to protecting margins, particularly in a downturn.

The extreme value of this mapping model is in its flexibility. When working with our clients we run the model on their core business, utilising the products, applications or markets, which by a simple Pareto analysis make up 80 % of their business. Depending upon the positioning of the products on the matrix there are specific pricing guidelines.

For high competitive advantage products, there is a clear need for strategic pricing at a premium to cost and to competitors. Identify those customers who are buying this competitive advantage. Keep the prices high. Ring fence them with exemplary service levels.

Where there is low competitive advantage tactical pricing is needed but you must have exceptional competitor knowledge especially related to their pricing. Don’t buy this business, offer alternatives at the same price.

High buyers risks exists where your products are perceived by your customers to be of high strategic importance to them. Your products may also form a major portion of your client’s annual or contract spends. You may be the only approved supplier; anything that places your product or service in this segment should be priced at a premium. But you must continually elevate the switching costs. Your package must make it doubly difficult for the customer to contemplate changing suppliers. Provide security of supply.

Where there is low buyers risk the attitude of the market will always be 'why pay more' so prices will have to be at or slightly below the market average. If you are trading in this area of the market it is vital that you find a way of isolating the prices; you don't want these lower prices to spread into the rest of the market. Give the products a different name or a different branding.

High perceived 'quality' (as perceived by the buyer not yourself) again represents a premium price opportunity; in this segment the customer will be prepared to pay a premium but the 'quality edge' must be maintained. It is particularly in this segment where 'micro' differentiation is of paramount importance. You must continuously 'massage' the quality perception.

It is unlikely that you have customers buying products which they perceive as being of low quality; but if you have is it business that you really want. These customers could well be consuming lots of activity for little gain.

### ***Conclusion- MANAGING IN A DOWNTURN – SHAPING YOUR BUSINESS FOR THE FUTURE***

#### ***SOME IDEAS TO HELP YOU FLOURISH IN THESE UNCERTAIN TIMES***

- ?? Cost cutting as a policy on its own is bound to be less effective than a policy that encompasses cost cutting with proactive price management as a complimentary activity.
- ?? Merely pulling on one of the levers on profitability rather than all three together is little more than a 'knee jerk' reaction to any particular business climate at any particular time.
- ?? Proactively managing pricing issues especially in a depressed market will have a greater effect on profitability than any other activity.

Patrick Harlington of Ansa Business Development runs custom designed seminars for client companies worldwide. Subjects range from winning profitable sales, profitable negotiation, price management, purchasing for profit and communication and teamwork skills amongst many others.

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