# FOUR COMMON
# PRICE LEAKS
## & HOW TO FIX THEM

INSIGHT2PROFIT

You won’t find a definition of “price leak” in your Merriam-Webster, so here’s one that’s easy to remember: **A price leak happens anytime you provide value but don’t get paid for it.**

Price leaks in and of themselves aren’t necessarily bad. After all, there may be very good reasons to deviate from a published price.

**With that said, here are two price leak rules to live by:**

**Rule No. 1:**
Price leaks shouldn’t happen by accident

**Rule No. 2:**
Price leaks shouldn’t happen without accountability

Every price leak in your organization should be known, measured and managed explicitly.

Before you can measure and manage your price leaks, you have to identify them. **Here are four of the most common price leaks and our best practices for handling them.**

# Common Price Leak #1: Freight

*"Sorry, I can't offer you a lower price, but I can give you a deal on freight."*

Freight is arguably the most common leak for manufacturers. If the product you make is heavy, freight can be a large component of your end price. It's also an easy element for sales teams to negotiate away, simply because it's often not as tightly controlled as price. And yet if you're eating your own freight charges, your profitability is slowly eroding away.

## How to Stop the Leak

### Make sure everyone knows your freight policy

You'd be surprised how often people just don't know—or have different interpretations of—what your freight policy is. We've seen evidence that sometimes simple awareness is enough to bring everyone back on board.

### Look at how well you're following your freight policy

At first pass, the data may show that your company is at, say, 50 percent compliance. But when you break the data down, whether it's by territory, customer or sales rep, you'll find that some people follow the policy 95 percent of the time and others follow it...never. Hint: It might not even be that particular customers are demanding it; it's just that some people are very quick to say "yes" when asked to make a deviation.

### Decide on a "next step"

Examining your freight policy may reveal a training opportunity. For example, you may require the sales team to obtain manager approval for discounting freight charges over a certain limit. Or, simply requiring the team to document all exceptions may nip the problem in the bud.

Alternately, you may realize it's time to re-evaluate your freight policy. Is your policy right for you today? It can help to look at how your top three competitors handle freight, as a benchmark.

# FIXING A FREIGHT PRICE LEAK

## A REAL EXAMPLE

We recently worked with a market-leading company that manufactures heavy metal components. Freight is a major cost for them—as much as 10 percent of the total value of the product.

It was common practice in their market not to charge freight. However, **we challenged their assumption that because their competitors didn't charge freight, they couldn't either.**

We pointed out that they were the market leader; we further suggested that their competitors didn't charge freight because they didn't—which created a vicious circle in which everyone was too afraid to make a change.

The sales team was skittish with what we were suggesting, since they were naturally afraid of losing orders. **But the company leadership saw this as an opportunity to change the dynamic of the entire market.**

The first year they charged freight, they collected $1 million in additional revenue, for a 1 percent sales growth accomplished without selling any additional product.

**It was a big win that changed the mindset of everyone in the company.** It also showed the sales team they had more power to influence their customers than they realized.

# Common Price Leak #2: Payment Terms

We often ask our clients, *"How long ago did you establish your payment terms policy? And what was the interest rate then?"*

Chances are it was very different than where interest rates are today.

Most companies today still offer very favorable terms, such as 1% 10 Net 30. Back when interest rates were high, it made sense to try to get paid as quickly as possible. But with interest rates as low as they are today, that no longer makes sense. Early payment discounts simply mean you're giving money away.

That assumes you offer standard terms. What you may find is that you do offer standard terms, but then you have 25 different exceptions. As a result, some customers pay in 45 days, others pay in 60, and they all get a discount. You end up with countless variations and payment terms, most of which are favorable to your customer but unfavorable to yourself.

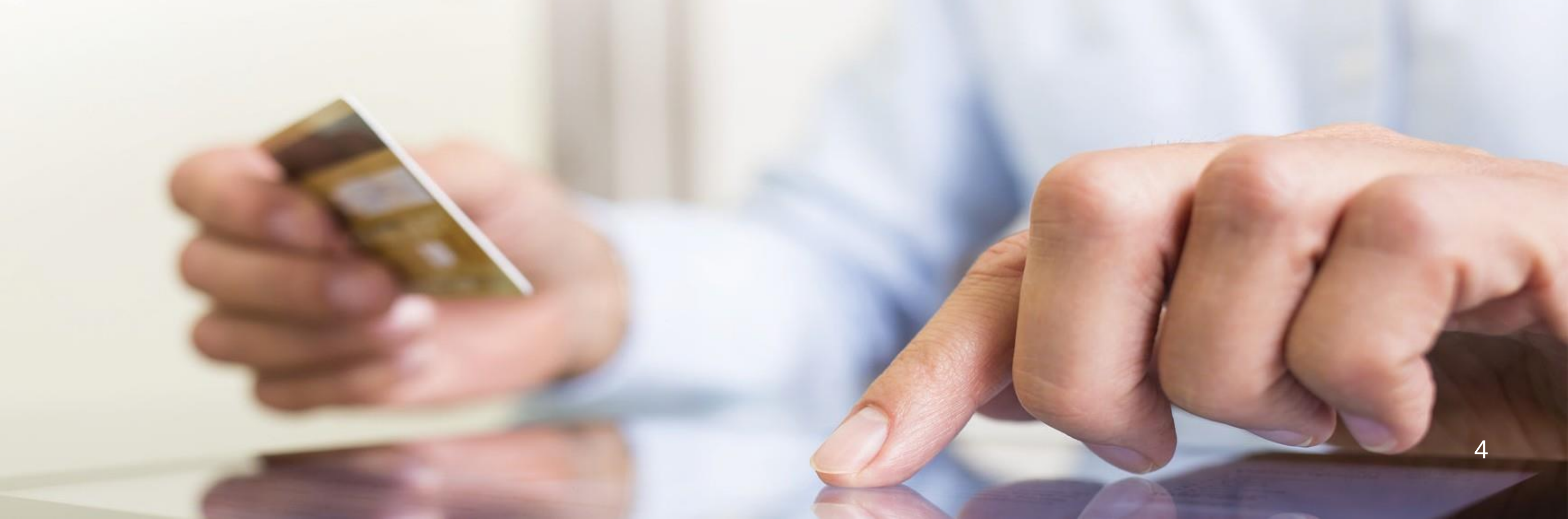
Also, consider that many customers pay with a credit card, particularly if you sell to small businesses. You're potentially paying very high processing fees, usually around 2 to 3 percent.

If you allow a customer to pay by credit card and also still get the early payment discount, and you're paying the credit card processing fee on top of that, **you're losing money hand over fist.**

## How to Stop the Leak

### Evolve your payment terms to match the times

What made sense when interest rates were at 10 percent doesn't make sense today. We recommend every business conduct an annual review of their policies. Ask yourself what has changed in your market—from the financial environment to the competition, technology, etc. Is your policy still relevant?



# Common Price Leak #3: Minimum Order Quantities and Expedited Delivery

Most manufacturers prefer to run large lots. Occasionally, though, customers might want to buy small quantities.

These small orders are likely expensive to process and ship. There may be a lot of value in a small order for the customer, but **this value comes at a very high cost to you.**

Alternatively, your normal lead time might be two weeks, but a customer might need their order in three days. Sure, you might be able to jump through hoops to make that expedited delivery happen on time... **but are you being paid for it?**

## How to Stop the Leak

### Standardize your processes

This is often easier to do than sales reps think. For example, if a customer requests an expedited delivery, typically the rep must first check to see if the request is do-able. They may have to put the phone down and go talk to production or the warehouse. **This built-in pause opens up an opportunity.**

When the rep gets back to the customer, the rep can say, “Yes, we can meet your need. Understand that there’s going to be a $500 surcharge (or 5 percent, or whatever your policy is) for us to process that expedited order.”

**Perhaps half of the time, the customer will withdraw the request. This is good.**

This means the customer didn’t really need their order so quickly after all; they were simply never told “no” before, and so they never thought twice about asking. By disrupting the dysfunctional process, you didn’t need to disrupt your production to meet a need that wasn’t real.

**The other 50 percent of the time, the customer will gladly pay** because the fee is so small relative to their need, which might be very great. Perhaps your product is critical to keep their own production lines running, or perhaps your product will help them meet a need with their own customer.

For example, consider what happens when it’s Christmas Eve and you realize you forgot to buy something on your list.

You go online to order from Amazon. Are you going to balk at a $30 delivery fee? Of course not, because you absolutely have to have the gift.

It’s the same with your customers; if they absolutely have to have your product, they’ll pay for it. If they don’t, the surcharge is an easy way to weed out those requests.

# Common Price Leak #4: Rebates

**This is where price leaks can get tricky.**

With a rebate, you offer a particular discount for a particular size order. The rebate might even have been profitable, initially. The problem is that **over time, rebates tend to become entitlements.**

As time passes, this dynamic becomes harder and harder to change. We've seen situations where companies *give away half of their profit margin* in the form of rebates—and feel powerless to change.

## How to Stop the Leak

### Understand your value proposition

Identify those markets where your value proposition is strong enough to stand on its own—where you don't need the rebate to make the sale. This can become a bit of a gut check, because at some point, you have to tell the customer you're not able to offer the rebate anymore. It can be hard to say "no" to a customer. But if your value proposition is strong enough, you can make it happen.

### Make your price policy the system default

If you want to really improve your price leaks and sustain those improvements over time, systematize the policy. Make your price policy part of your ERP or other operating system. Set it so that overrides can only happen with the appropriate approval levels, and reports are produced on a regular basis to monitor compliance and policy deviations. To the extent that you can make this the default in the system, you'll enjoy significantly easier success.

## It's not that every leak is a bad leak.

There may be good reasons to deviate. But deviations should be the exception, not the rule.

The key is to understand your policy, look at your data and ask yourself, ***"What is really happening here?"***

INSIGHT2PROFIT is headquartered in Cleveland, OH with regional offices in Chicago and Columbus. INSIGHT employs more than 250 professionals and has appeared on the Inc. 5000 fastest-growing companies list in America for ten consecutive years. INSIGHT2PROFIT delivers tangible results be developing and implementing data-driven pricing strategies and tailored software solutions to help clients achieve continuous profit improvement.

---

For more information about how INSIGHT2PROFIT can answer your questions about pricing, visit: www.insight2profit.com

---