HBR CASE STUDY

The Case of the Pricing Predicament

Cost-cutting customers. Hungry foreign rivals. Should Standard Machine lower its bid?

by MARY KARR

As soon as Scott Palmer's secretary told him that Joanne Braker from Occidental Aerospace was on the phone, he knew he was in for a long day. Inheriting the Occidental account had helped him earn top sales commissions last year, his first at Standard Machine Corporation. But a month ago, Joanne informed Scott of the purchasing department's new, more aggressive competitive bid policy, and said it would apply to the acquisition of a computerized milling machine for Occidental's new training center.

Scott nevertheless submitted his $429,000 proposal with great confidence and even boasted to his regional sales manager that the deal was "in the bag." After two weeks of unreturned phone calls, however, Scott got the feeling his confidence had been sorely misplaced.

"Hi, Joanne. Long time, no hear. What's up?"

Joanne got right to the point. "Scott, I've got a $22,000 problem you can solve."

"What do you mean?"

"You know we have to look hard at a number of different vendors on purchases of this size. And your bid is well above the competition's. Kakuchi came in under $390,000, and Akita Limited at a little over 400K."

> Joanne: "Scott, your bid is $22,000 too high; I just can't sell that here."

She waited, and Scott waited back, not wanting to show his anxiousness. "The way I count it," she finally continued, "you're $22,000 too high, and I just can't sell that here."

"Well, Joanne, you get what you pay for in this world. You know that Standard's got the best machine tool equipment in the world. Not to mention our service and training. So we have to sell at sensible list prices, no more no less, if we want to keep providing the kind of products and service you expect from us."

Scott began to recount Occidental's long and fruitful relationship with Standard, and the unmatched performance of its milling, grinding, and boring machines. But Joanne interrupted. "Scott, you don't have to sell me on your equipment," she said. "And you understood what the new bidding policies meant when we announced them. We're under the gun to cut costs, so we have to look at other suppliers. I just can't budge on this till you come down to the middle someplace. That's the way it is."

Actually, Scott had always wondered just when Standard's fixed-price policy would meet strong resistance from a customer, but he had not expected complaints from Occidental. That company had maintained its manufacturing edge by investing in the sort of state-of-the-art automation Standard provided, and it had installed virtually nothing but Standard equipment for more than 20 years.

Scott told Joanne he appreciated her problem and her frankness about the other bids. But he continued to argue Standard's case. "We ship a lot more equipment than the others," he maintained, "and we ship it on time. Our prices have to reflect that. And you've seen how we train your operators and hang around after installation until everyone's up to speed."

"Akita and Kakuchi say they will too," Joanne replied firmly. "I should tell you they both provided some pretty convincing testimony from other U.S. accounts."

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"I don't want to knock Akita," Scott responded. "Some of its basic equipment is decent. But how reliable will it be in a crunch? What would it have done when you bumped up against capacity last year? Installed practically overnight like we did? It would have had to train your staff in Japanese in 24 hours." He paused briefly for effect. "It's awfully far away when you're in a bind."

Scott: "The competition's prices are lower, but how reliable will they be in a crunch?"

"It's true that none of Akita's customers have plants that are as big as ours, or that seem to be growing as fast," she conceded.

"By the way, did you take a long hard look at Kakuchi's software?" Scott bore in. "If your people can figure out how to use it, they'll get a Nobel Prize. Its training division is almost nonexistent. And I hear some of Kakuchi's European customers call their field service group, 'field circus.'"

Joanne laughed. "I've heard that too. That's why we're hoping to get you close to Akita's bid. Its A71 package looks pretty good."

"Pretty good isn't good enough, Joanne. You know that and I know that. I'm sure the rest of purchasing knows that. And do you think the guys in manufacturing want to compromise on quality to save 5% on a piece of equipment?"

"Look, Scott," she said, "we all know what we know. You know Akita's solid, and so is its equipment. And its managers know there's a lot of potential business in the two plants we're planning to build over the next four years. Everybody in the industry knows those plants are on the drawing board. So it's really a question of your attitude toward the future, not just the quoted price on one piece of equipment."

Joanne said the deadline for final bids was in two weeks. Scott explained to her that he couldn't give an inch on price unless he could convince his regional manager, Tony Della Pena.

Scott hung up, and his mind turned immediately to the office down the hall. He wondered whether a carefully worded memo to Tony might not get better results than simply walking into his office. But because he felt he was battling the clock, Scott went straight to Tony and briefed him on the conversation with Joanne, finally suggesting that Standard rebid at $407,000.

Tony held firm on the original proposal. "Scott, you've done great work in a year, really first rate. But if you'd been selling for us a little longer, you'd understand why we don't dicker with our prices, even slightly."

"But Tony, think about those two new plants. Joanne practically promised us that business for $22,000 less on this deal. It doesn't seem smart to let Occidental get experience with other equipment and suppliers now."

"I know, I know. I've seen the new products from Akita and Kakuchi. The software on the A71 looks pretty damn good. And Akita hasn't been so terrible on service in the U.S. since it built those field centers here."

"I wasn't aware of that," Scott said sheepishly.

"But there's a lot more to this business than price," Tony continued. "We don't want to mess up the industry. We aren't selling a commodity. Of course we want Occidental's long-term business, but we can't let every customer nickel-and-dime every bid. Do that, and you might as well be selling sheet steel."

"I know we want stable conditions. But it's not as if we're losing money with $407,000. And we may lose a big account just as it's about to get a lot bigger."

"Scott, you know how this company got where it is. Standard is founded on quality and reliability. We're innovators. We can't stay ahead of the curve if our prices don't support our development costs. How many man-years do you think went into building the software for our 1052? Or into upgrading it to work with new production processes? And you know what we spend on customer service. That's why we've had Occidental's business for all these years – by thorough installation, training, by rushing spare parts to them." Tony paused. "By paying our salespeople enough to know what's going on with our customers. It's not to Occidental's advantage for us to cut prices if it means it'll lose its manufacturing edge in the future."

"I hear what you're saying, Tony. But right now Occidental doesn't seem to value our service and support as much as the money it wants to save. Couldn't you at least go talk with Bob Davis about making one minor adjustment to the fixed-price policy?" Davis was corporate vice president for sales.

Tony: "I'm not going up the line to argue for an exception to a policy that's been around longer than either of us."

"I'm not going up the line to argue for an exception to a policy that's been around a lot longer than either of us have." Tony looked resolute. "This is an old company, and a successful one. You don't go running to the fourteenth floor every time you get a decision you don't like, Scott. Why don't you see what else you can do for Occidental instead of complaining to me about our pricing policies?"

Scott got the message and started toward the door, remarking as casually as he could, "Winter is coming, Tony. We could both use a week in the sun. And those new Occidental plants could bring us some pretty nice rays."

Back in his office, Scott gathered evidence for the memo he realized he should have sent Tony in the first place. Tony had chided him in the past about being too impatient to close a deal in a business where the sales cycle tended to be long. Scott thumbed through trade magazines for articles on the Asian invasion and sent his secretary to the copy machine loaded with nightmare stories about the dwindling market share of established U.S. manufacturers in industries like Standard's.

By quitting time, Scott had completed a succinct memo that outlined to Tony three possible compromises on Standard's fixed-price policy:

1. For Occidental only, Standard would rechristen the 1052 as the 1052X, change the color of the control panel from gray to blue, make a few other cosmetic changes, reduce the motor's power slightly, and offer the revised machine at $407,000.

2. Standard could rebundle the 1052 service package to justify the $407,000 price tag. This would mean eliminating the usual one week of on-site operator training and cutting back the time troubleshooters would remain at the facility after installation from two weeks to one. In addition, it could trim the "free" six-month service period to two months.

3. A modified combination of the first two alternatives could also cost $407,000.

As an addendum, Scott wrote a brief analysis of encroaching global competition, supporting his arguments with the articles from the trade press. He also reminded Tony about the recent Munich trade show, where other salespeople had complained of losing large accounts because of price competition, particularly from Akita. Scott thought his arguments were solid, but Tony had to decide where to go from here.