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Behavioral Discount Management

More profitability in sales with behavioral discount management

Many companies do not necessarily have a pricing problem but a price enforcement problem, which leads to a considerable discrepancy between list and transaction prices. Therefore, behavioral discount management is a massively underestimated lever that helps companies set prices "correctly" and prepares their sales force for price enforcement.

Behavioral Discount Management

Behavioral discount management is a massively underestimated lever for increasing profits. Many companies do not necessarily have a price problem but a price enforcement problem, which leads to a considerable discrepancy between list and transaction prices. A condition that sustainably destroys margins that companies desperately need. Yet many behaviour-based levers enable every sales employee to enforce prices better in the long term and close the gross-net gap more successfully.

Strategy and enforcement are the two inseparable sides of professional pricing. The best pricing strategy is useless if it is not implemented consistently, and even the most consistent price enforcement cannot remedy an incorrect pricing strategy.

Especially in industries where list and transaction prices are typically far apart, such as in many B2B or negotiation-intensive B2C businesses (e.g., insurance or automotive), the key approach to quickly and directly improving a company's earnings is not necessarily to redesign the pricing strategy but to improve price enforcement.

The greater the gross-net gap, the greater the potential for well-thought-out discount management. Every percentage point of discount not given is lost margin that can only be achieved with extreme difficulty via an alternative increase in sales in the future (more on this later).

Every percentage point of discount not given is lost margin.

At the same time, the individual negotiation and discounting strategy of individual sales employees in the last mile ("in front of the customer") represents a black box for many companies, and it is unclear what actually happens there. This is despite the fact that, in the cases described, the last mile is more decisive for the company's profitability than strategic pricing in the first mile ("at headquarters").

Where and how much margin is given away through discounts

Our projects in the area of sales optimization have shown time and again that 50-80% of the discounts given are granted unnecessarily, and companies thus give away considerable margin potential.

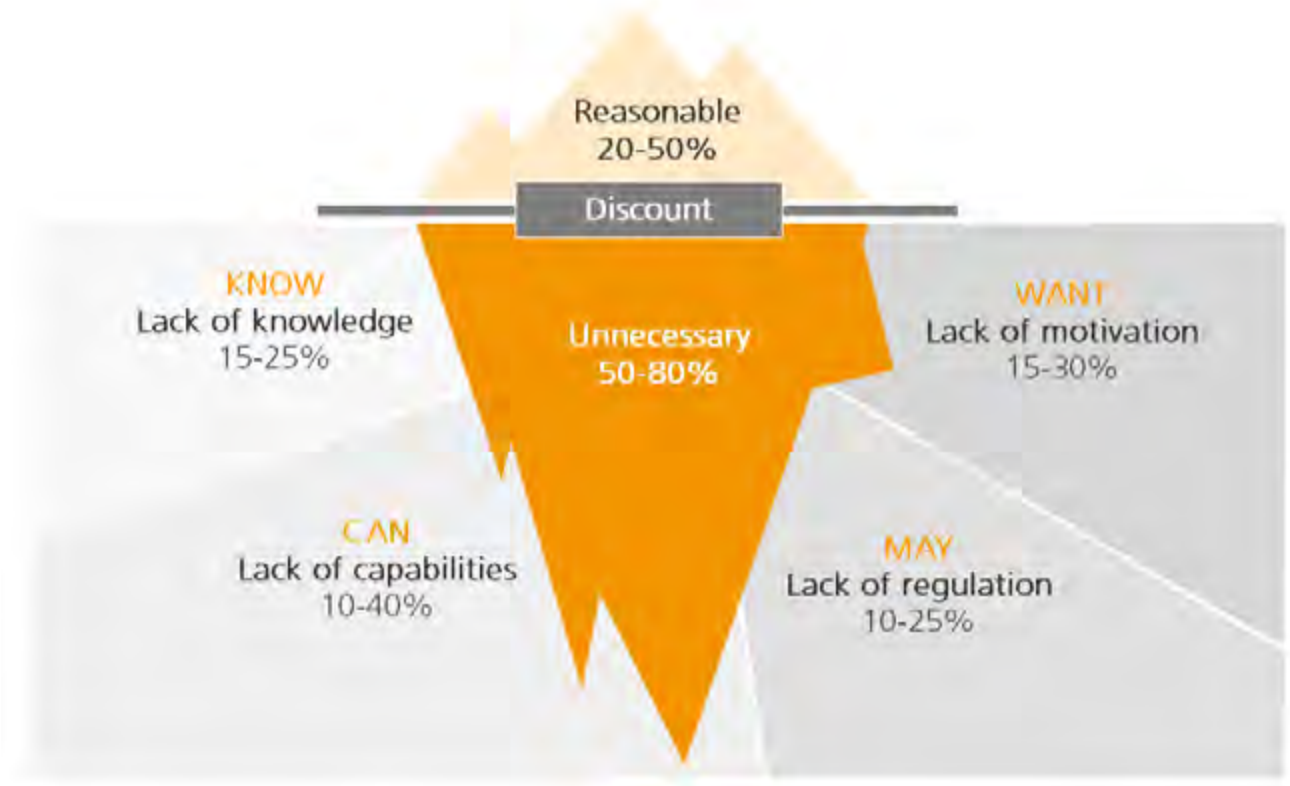
However, unnecessary discounts do not only waste margins and cost money in the short term but also have fatal consequences in the long term. The reason is that a discount unnecessarily awarded today will become the new reference price of the negotiation tomorrow and, thus, a long-term margin killer. The short-term focus on quickly increasing sales typically overlooks this consequence.

When and how to give discounts

Not all discounting is unnecessary or harmful in the long run. On the contrary, discounts can be essential sales tools if, for example, ...

- the discount triggers a purchase decision that the customer would not otherwise have made, i. e., it helps the customer cross the "Rubicon" if that final spark has not yet been ignited.
- the discount is used to draw customers into higher-value options or to promote cross-selling.
- the discount uses individual price differentiation to open up new customer segments that otherwise could not be won without other customers developing the same price expectation.
- general long-term costs, such as those incurred by becoming accustomed to expectable discount promotions resulting in declining margins in the long term, are demonstrably lower than the short-term benefits of acutely higher demand.

Figure1:
The discount iceberg



Discounts must be used selectively, and long-term consequences must be considered..

If there is a green light for discounts with a view to these functions, they should ...

- be justified (otherwise, they appear arbitrary and become the new standard expectation of customers).
- be linked to specific counter-performance by the customer (otherwise, they damage the credibility of the normal price level and thus the price acceptance of customers).
- not be granted predictably (otherwise, customers will just postpone their purchase decisions to these periods).

So the most important rule is: Discounts must be used selectively, and long-term consequences must be considered. Always ask yourself whether the customer would have made the purchase without a discount and whether the short-term gain is worth the long-term effects.

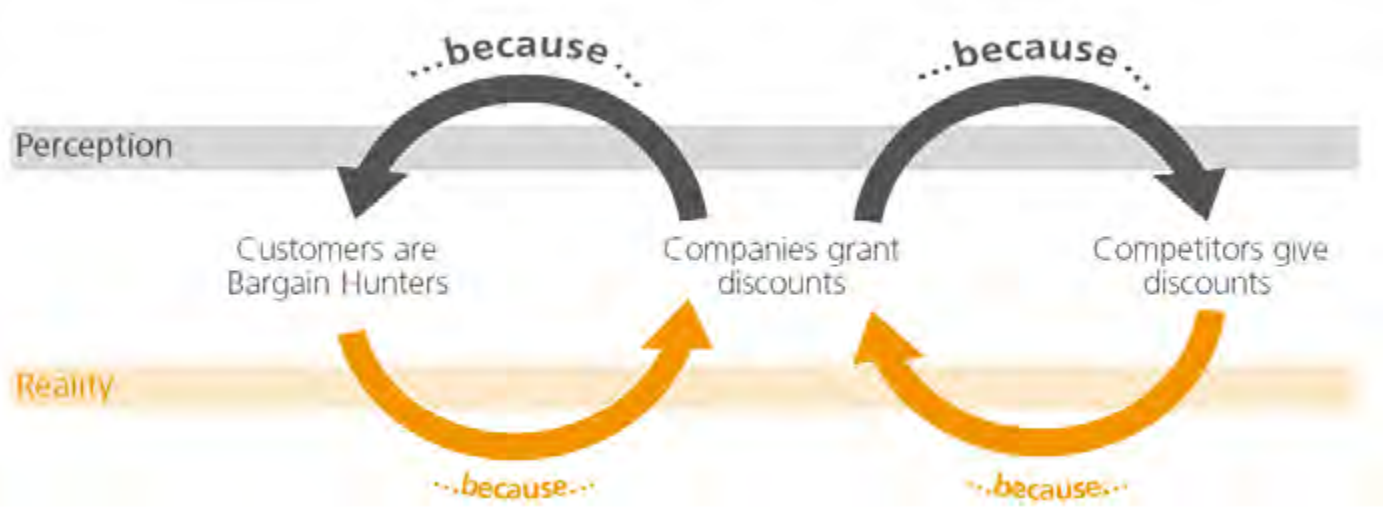
Why this most important rule is so difficult to follow

Two of the most common reasons for disregarding this rule are the following vicious circles that reinforce each other:

1. Vicious circle: Companies often assume that customers are primarily bargain hunters. Any inquiry about the price is quickly misunderstood as a demand for more discount. But customers inquiring about the price do not always do so because they would not buy without a discount. They often only do so because they want to understand the calculation or to fulfil their obligation to have at least asked again.

If the company grants discounts because of the chronic "customer = bargain hunter" assumption, it quickly becomes a self-fulfilling prophecy: Even customers who were not bargain hunters were raised to be bargain hunters as they were rewarded with unexpected discounts whenever the issue arose.

Figure 2:
The self-fulfilling prophecies in discount management.



2. Vicious circle: The second vicious circle is the orientation towards competition. This is also a self- fulfilling prophecy:

The most common internal justification for giving discounts is to keep pricing "in line with the market" to remain "competitive". And if you ask a company that started price wars, the answer is a reference to the competition.

This leads to undercutting and discounting competition, which is not the customers' fault, but the companies' fault.

The lowest common denominator of the mistakes that lead to these vicious circles is often the sales force's beliefs and individual sales behaviour.

This is why all measures must start with the sales department. "Behavioral Discount Management" is the key to a sustainable profit increase.

Salespeople typically think customers are more price-sensitive than they actually are.

Reasons & solutions for unnecessarily granted discounts

Specific negotiating and discounting behaviour is always determined by many influencing factors. This is why we have divided the leading causes of unnecessary discounts into the dimensions "Know," "Can," "May"," and "Want below and provided suitable solution proposals.

Dimension #1: "Know"

Wrong assumptions, missing targets, lack of transparency

15-25% of discounts are granted unnecessarily because sales employees misconceive the customer, their price knowledge, price acceptance, and decision-making strategies. They often assume they must give customers "a good deal" to convince them to buy. Simultaneously, the percentage of bargain hunters among customers is chronically overestimated, and every question about the price is immediately interpreted as a call for discount negotiation.

As a result, sales staff focus too much on the price, even mention it themselves, and thus give discounts that the customer often wouldn't have needed. And unless these errors are documented, they go unnoticed.

A discount unnecessarily awarded today will become the new reference price of the negotiation tomorrow and, thus, without exception, a long-term margin killer.

Solution

Create understanding, define goals, provide transparency

First, companies should eliminate internal beliefs ("The customer wants a discount") and create a fact-based understanding of the role that prices and discounts play in the customer's decision-making process. This is achieved by showing employees what other arguments (apart from

the price) lead to a deal and how many existing customers are bargain hunters in the first place. This also includes pointing out that other customer types are put off by discounts because it makes them doubt the quality of the products. More on this under Dimension #2 "Skills": Ingrained routines, lack of capabilities.

Besides that, the sales staff should be aware of their negotiation goal. For example, what is the target price, a fair entry price, and the walk-away price (the price at which the negotiation is discontinued)? It also takes the pressure off sales staff to keep or acquire every customer (with a discount far too high).

target as to which level was to be achieved for which sales: The smallest customers got the biggest discounts, and at an average of well beyond 40% off the list price. In the case of one individual customer, it was entirely unclear why the discount had been given in the first place.

Creating this kind of transparency for everyone also helps prevent battles of faith over the question of which customers need which discount level.

Figure 3:
Customer example – erratic discount allocation

Reliable discount monitoring is also essential for documenting why a discount was given, how much discount colleagues give to similar customers, and which customer segments should receive how much discount and how consistently.

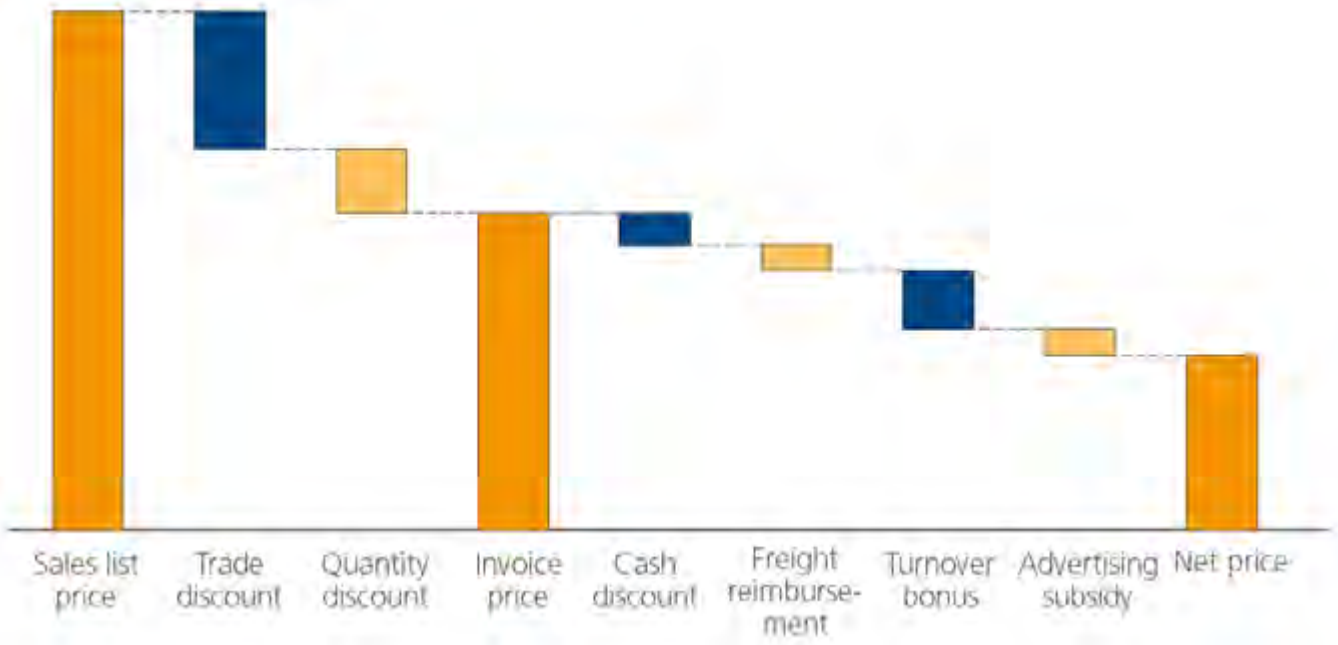
If these three conditions are not met, discounting could be as erratic as it was with one of our clients in the media industry (Figure 3). There was little documented justification as to why a discount was given, nor was there a clear

These battles of faith are hard to decide and rarely won – especially not by a manager who does not know the customer directly. Therefore, it is much better to let the data speak for itself: Who systematically sells at below-average discounts and above-average discounts?

If these numbers are transparent, the request for more discount leeway changes to the question of how to get by with less, and the discount negotiation shifts from an internal one – between supervisor and sales employee – to an

external one – between sales employee and customer. Besides the analysis of discounts per customer or discounts per sales employee, the so-called price waterfall (Figure 4) is also a fundamental analysis to get a grip on the cause of unnecessary discounts.

Figure 4:
Price waterfall



Dimension #2: "Can"

Ingrained routines, lack of capabilities

Poor negotiation skills, inadequate preparation, and a lack of self-confidence to counter requests for discounts or at least not offer discounts early account for another 10-40% of unnecessary discounts.

This often involves sales routines that have become ingrained over the years and automatically focus on prices and discounts.

Solution

Break routines, provide continuous coaching, sell on two dimensions

In sales, people often assume they are simply selling a product and its features. So they have to explain all of them, if possible, and then hope that the customer understands them and buys. If he does not, they explain the advantages of the product again. If the customer still does not buy, they give him a discount.

This classic sales approach only focuses on the "value" of the product, i.e., WHAT the customer presumably wants. It entirely neglects the customer's decision-making strategy, i.e., HOW he decides. Selling is ultimately about influencing purchasing decisions. If the sales employee does not know the decision-making strategy of the customer and cannot read him on this dimension. In that case, he risks using the wrong tactics and being too quick to offer discounts.

However, it takes more than theoretical understanding to be able to read out the psycho-logic behind purchase decisions from the conversation and to apply it in practical customer interaction. It is instead a matter of breaking away from the ingrained focus on the own product or service and adopting a new perspective on the customer and his decision-making process.

Decision-oriented segmentation for pricing and selling, such as the GRIPS typology, can be used for this purpose. It distinguishes between five different types of buyers who, in a decision-making situation, rely on different heuristics (rules of thumb) to make a decision and thus need to be addressed by the sales team in different ways. You will find more information about this here.

Sales must take the focus off their own product or service and adopt a new perspective on the customer and their decison-making process..

For example, integrated into the daily work routine, coaching sessions help build a self-confident team that can immediately recognize the different buyer types during a sales pitch. Thus, the team can use other price-independent tactics – e.g., with the help of type-specific battle cards – at the right time.

Dimension #3: "May"

Rigid systems, no rules, lack of responsibility

A discount system that is too rigid and does not allow individual discounts, such as 8% or 9.3% (instead of 5%, 10%, or 15%), reduces the sales staff's leeway for no good reason and usually forces them to give more unnecessary discounts. This sounds terse, but it is the reality of sales in many companies. Also, escalating the decision too quickly (e.g., to expand the discount limit) often leads to a situation where the supervisor, who does not know the customer and thus cannot make an informed decision, has to take responsibility.

This is quite a dilemma: If he does not grant the discount, the sales representative will argue that he cannot reach his sales targets. If he grants the discount, he has taken over the responsibility, and the sales employee with the actual customer contact is "off the hook."

This leads to notoriously excessive discounts and an enormously high burden on managers who have to handle these requests repeatedly. Experience shows that 10-25% of all unnecessarily granted discounts in companies fall into this category – sometimes with strong aberrations, as the following real-life example illustrates:

Client example

One of our insurance industry's customers had a defined maximum discount of 25%. However, customers were granted an average of more than 32% discount. How could this happen?

This discrepancy arose because over 75% of the negotiations were escalated in the way described above, and 90% were actually accepted. This meant enormous internal costs and a considerable margin loss for which no one felt responsible.

Solution

Install governance, optimize escalation processes

The decision-making power on discounts should, in principle, be tied to the person who knows the customer best – in line with the principle: "Keep out the boss!" Because even if a higher hierarchical level in companies means more decision-making power and responsibility: The management level can rarely judge whether a discount is justified or not. After all, in most cases, management has never spoken to the customers and therefore does not know their decision-making process. Their role should be that of a coach, helping to reduce the discount rate, not increase it.

Furthermore, the intervention of a superior in the negotiation not only takes away the responsibility of the sales employee for his own price enforcement performance but possibly undermines his competence towards the customer if the customer becomes aware of this.

Keep the boss out!

Besides helping with difficult customers in the background, management should not decide on the approval or rejection of further discount margins. Instead, the focus should be on how much additional revenue the sales employee is expected to generate with a higher discount to make up for the lost margin.

If sales employees want a higher discount for their customers, the decision can be pushed back by management by showing the employees the sales increase they must achieve in the future to make up for the discount granted (Figure 5, p.11).

This measure – just like the increase in transparency of the discount levels of other sales colleagues – also helps shift the discount negotiation between supervisor and employee to the employee-customer interface, which is where it belongs. Thus, every employee starts to think about profitability and less about individual financial statements.

Figure 5:

Discounts and the actual need to increase sales

List price	Discount	Costs	Profit contribution	Necessary increase in sales
100 €	0%	70 €	30 €	-
100 €	10%	70 €	20 €	+ 50%
100 €	15%	70 €	15 €	+ 100%
100 €	20%	70 €	10 €	+ 200%
100 €	25%	70 €	5 €	+ 500%

x 1,5 x 2 x 2,5 x 2 x 4 x 10!!

Never discuss discounts on their own during internal discussions or escalations because you miss critical consequences. When discussing discounts, always reflect on the sales increase required for its compensation. Sometimes that can change or settle the discount-debate quite quickly..

This point is about the "gray eminence" in Behavioral Discount Management - the Incentive System:

Dimension #4: "Want"

Lack of motivation, unfavourable incentives

15-30% of discounts are given unnecessarily due to sub-optimal motivation and incentive systems. No matter how well the sales training, tools, and tactics are designed, if the sales team is incentivized primarily by sales quotas and revenue targets while at the same time being able to set its own discount levels (or simply escalate the decision to management as described), the result is an explosive mix that continuously and reliably erodes margins.

Discount negotiation should be shifted to the employee-customer interface – that's where it belongs.

So, the problem is not the employees, but the incentive system, which promotes this self-optimization to the detriment of the company's profitability.

Solution

Harmonize interests, align incentives

The focus away from individual deals toward profitability harmonizes the individual interests of the sales employee and the company's overall interests. This critical step motivates the sales staff to give fewer discounts.

When changing the incentive system, it is not necessary or possible to adjust everything at once. It is more about developing a target image and the successful migration from the current status to this target. It is helpful to take a three-step approach:

1. A quick win is often to improve the sales team's transparency and understanding of discounts' monetary impact on individual incentives. A lot can be achieved with simple means and intelligent, preferably immediate feedback and behavioral economic approaches. Also helpful is peer feedback on the discount performance of other colleagues.

This competitive aspect sometimes triggers more commitment than any monetary incentive.

2. The next step is to systematically record corporate goals, desired behaviours, and individual incentives and check whether they are actually aligned. Even eliminating inconsistencies and removing unfavourable incentives can significantly impact the medium term. In some cases, it is possible to include a profitability-related component in addition to the revenue-related incentive components, e.g., an incentive-based on relative and absolute gross profit. This can further accelerate the change in perspective from completion rates and sales to profitability

3. At the same time, however, a long-term vision should be developed for a target incentive system that is also structurally aligned to price enforcement and rebate management. With such a vision in hand, negotiations on how, in which stages, and when this target incentive program is to be achieved can begin immediately.

As you can see, the best pricing strategy is nothing without well-thought-out price enforcement, and the best price enforcement cannot save a failed pricing strategy. Feel free to contact us if you would like to leverage the potential of Behavioral Pricing and Selling in your company.

About the artist

Iryna Fedorenko is one of the best-known Ukrainian artists and art critics with over 20 years of creative experience. Over the last three years, her work under her artist name Semira has been shown in more than 50 exhibitions in museums and galleries in Europe, the USA, and Asia. She was born in Mariupol and worked in Kiev until she fled Ukraine at the beginning of the war. Today she lives in Munich with her son and mother.

In the series "Children of War," the artist captures the current situation by portraying the astonishment, horror, and difficulty in understanding war in the children's facial expressions. Several paintings from the series are currently on display at the Columbus Museum of Art in Ohio, USA, in various galleries in Germany, Belgium, Latvia, and at the 59th Venice Biennale in Italy. Before the war began, Iryna was best known in Ukraine for her impressive portraits of private individuals and celebrities.

We are very proud to be able to show her artwork in this magazine. All images from the "Children of War" series and her portraits can be seen and purchased on her website at www.semira-art.de. Personal portraits can be ordered via iryna@semira-art.de.

vocatus:

At Vocatus we develop pricing strategies and sales concepts for B2C and B2B business models. In doing so, we do not rely on the assumptions of classic pricing theory. Instead, we systematically leverage the latest insights from behavioral economics to open up additional margins and conversion potential for our customers. For our innovative projects and the successes we have achieved with them, we have already received numerous international awards.

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