

Making Dollars and Sense Out of Pricing Strategies: What Service Providers Must Consider to Protect Their Own Bottom Lines

Times are tough. If you are in a service-based business, you know that some customers are price shopping. But before you decide to pull the trigger and reduce prices to keep clients or grow your business, take a time-out. Back away from your pricing rip-chord! Reducing your prices could be the worst thing you could do right now.

When I first started out with my business over 4.5 years ago, I made a few mistakes. That is putting it – ahem – mildly. What entrepreneur hasn't blown a few strategies when first starting out? If you haven't, you're either far more prescient than I am or not taking enough risks. Back then, one small business prospect asked me for a discount. I gave her one. She never returned. I did the work well. However, she was not my target market. I gave a discount to a small business with little money in hopes she would come back with more money. But small businesses typically don't spend anything on marketing. See the circuitous logic? Even if it is your target market, rather than cut prices, a better strategy is to find ways to add value so that price is not a perceived issue.

Price sets an anchor of quality and value in your customers' minds. How many times have you heard colleagues say, "If I give a discount during tough times, I'll keep this client and raise prices later." Let me know how that conversation goes after your client stops laughing! It doesn't work. Moreover, what's to stop your competition from also cutting prices? Find a way to innovate new services that customers care about, and you will avoid competing too much on price.

Price Measures Value and Risk

Perceived customer (yes, it's all from the customer's perspective) value (V) means that perceived benefits (B) outweigh perceived costs (C) of your services (monetary, transactional, opportunity costs, other risks, etc). Think about it this way: **V (customer) = B (customer) – C (customer)**

So, how do you increase value for a customer? You can reduce costs or increase benefits. And increasing benefits is the far better road in the long run. And in tough economic times, as Robert Frost might say, it is the "road less traveled by." There is too much temptation to reduce prices for the short-term wins. Yet, not cutting price will make "all the difference" in the long run.

Pricing is also about risk. If customers are spending a lot, they may expect you to help reduce the perceived risk of trying your products. Simultaneously, a service provider must be clear on how much risk he or she wants to take on through various pricing methods. While you can mitigate your risk with various strategies, you can't transfer all of your risk to the client. Conversely, you shouldn't absorb all the risk. When you add benefits, you reduce your client's perceived risk, and thus, pricing objections. You also preserve your value to the client.

Are there times you might consider price cuts? Maybe. But you are always better off preserving in your customers' minds the perception of value rather than the perception of "cheap." How much do customers value services that are free? You may think this is helpful and sometimes it is. But beware how much you give away for free. If a client doesn't have to pay, the association with value is reduced: "Hey, I didn't have to pay for it, so how good is it, *really?*" And, just as important, you must ask yourself whether or not you want clients that nickel and dime you to death. I know I don't. The transaction costs you will bear with "demanding" clients are high. You must factor that in to your pricing. If you can afford to subsidize a high-profile client with other clients in your

portfolio to get a foot in the door, you may decide the risk is worth taking. But remember – you have set a mental anchor on value. Try going back and raising prices later. I triple-dog dare you.

You also have your cash flow to consider. I have had large corporate clients. Why should I give them pricing discounts when I need to watch my cash flow? I have a well-known tech client with lots of cash and no debt that once took 4 months to pay my invoice. That's right – I gave them an interest-free loan on that cash. It's a cash management strategy on their end. *That's* their discount.

Adding Value

There are many ways service businesses can increase value for their best customers. The key is to find out what *profitable* customers care about. Not all benefits have to cost you a lot to offer, either. Here are a few things to consider when adding value and managing risk:

1. Help customers find additional savings. I had a customer in financial crisis because of a confluence of factors outside of my control. So instead of cutting my prices, I helped them find ways to save money on their marketing spend. The bottom line was I helped them save far more money than it cost to hire me. Lots more. Which brings me to point 2.
2. Find ways to minimize payment risk for you and your customer. Because of my client's cash constraints, I took most of the money up front and a percent of all savings I found (note: I was pretty sure I could find savings). There was no risk to the customer – if I couldn't find additional savings, they didn't pay me anything beyond the up-front fee. This is a 2-tiered pricing strategy that maximizes upside for the service provider (again, if the provider is certain they can achieve savings) and minimizes the downside for the client. Conversely, if you help your client win new business, then you can take a percent of that as well. Be sure to get some money up-front to pay for your time; a 100% contingency fee transfers all risk to you even if you are certain you can find savings to pay for your time.
3. If you have a high-risk client, get some payment up front. I had a smaller client with cash flow issues. I was paid 50% up-front before work started (to reserve my time), 25% after delivery of the next milestone and the final 25% after the final part was completed. Some clients may push back; however, for this client, it worked because it staggered out the payments and it split the risk for both of us. If the client didn't pay, I didn't move to the next stage. You have opportunity costs. If you decide to take on a high-risk client, bill up-front to get started. Getting cash up-front aligns everyone's interests. Remember that client that signs the contract and then you can't reach them to get started? If you've received payment up-front, your client is invested in seeing this project succeed.
4. Partial equity payments. This model has risk, but it can be lucrative **IF** the client is doing well. However, with small, pre-IPO clients, I have personally found this model too risky and without the upside. I did this twice, and I never accepted the majority of my fee in stock. The most stock I accepted was 25%, and 75% in cash. In these situations, the service provider bears most of the risk. Still, if you believe your client has a great product, real customers, actual orders, and a great management team, you may consider it worth the effort. In my experience, there are too many variables beyond the service provider's control to be able to make pre-IPO stock an upside situation. You are also trading cash today for *possible* (not guaranteed) future payment. You should be compensated for that risk. If you accept pre-IPO stock (or any stock for that matter), you should receive far more in stock (orders of magnitude more) than your invoice amount. You provided a huge

interest-free loan to the company to help them conserve cash. Factor that “loan” and interest into the amount you are willing to accept.

5. Offer value-added services and recommend value-added partners. Focus on your most profitable customers for this strategy. Some things you might think about include free training, extended hours or free services, and / or favorable payment terms (a small 2% off a 30-day payment term, for example). Help them get things done. Lighten their load. Some of these things do not cost a lot to offer. A free audit with cost-effective ideas to streamline their business is a great device. It's also a great way to get new business. But cap the audit to a small investment of your time up-front. This way, if the prospect doesn't sign the contract, you haven't sunk tons of time into the effort.
6. Offer promotional trials of your service for a specific, limited time if appropriate. Also, limit how much “service” they get for that trial period. Clearly define what that is so you can set expectations with your prospect accordingly. The point is to reduce risk of service trial for your prospect while also minimizing your exposure and costs for a “free” trial.
7. Delight your customers. You don't have to spend lots of money to do this. I had a client at a hospital. I brought her lunch to save her time. I did the same thing with a legal client. Make life is easier for them by giving them one less thing to think about. Your value and willingness to keep their business shows.
8. Upgrade your least profitable customers or fire them. This is one of the hardest things for businesses to do. Trust me, as a small business it can be hard to imagine actually letting a client go. You must know your margins across all customers. For your customers that are marginally profitable or unprofitable and that eat up more services than they pay for (you know the type with the tremendous hand-holding required), you must raise your rates. Try to upgrade them on service. If adding more value doesn't incent them to pay more, then you have to ask yourself whether or not these clients are worth keeping. Think about how much your time is worth. Once freed up from unprofitable customers, you can focus on profitable pursuits. Here's the reality about unprofitable clients – they aren't referring you anyway, because no matter how much you give them for free, they want more.
9. Remind your clients about your value *frequently*. I have a number of colleagues in the outsourced IT business, for example. Clients expect their IT investment to run smoothly. The only time you see or hear from your outsourced IT provider is when there are problems. Make sure at regular intervals – when things run smoothly and you don't see your clients in person much – that you remind them how much you have done for them. Show them on their invoices and regular benchmark reports all the extra services they have received and what those would cost them at full price. Out of sight is out of mind – and that is not where you want to be at renewal time.

The bottom line is you need to watch out for yours! The good news is there are a number of flexible pricing strategies that can yield a win-win for you and your client. The point is to add value for customers while minimizing risk – for them and for you. Value doesn't have to cost a lot for you to add, either. And, if you still find yourself seriously contemplating a price cut, call me. I'll talk you down from that ledge – *for free*. Now there's a value-added deal.

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