

FORETHOUGHT PRICING STRATEGY

A Case for Discount Discipline

by Jim Geisman and John Maruskin

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Considering the obvious effect negotiated discounts have on revenues and profits, you'd think they'd be subject to careful planning and vigilant oversight. Our research in the software industry, however, indicates otherwise. On a deal-by-deal basis, these discounts are given a lot of attention in the moment. But there's little strategic thinking before the fact and seldom any examination of the pattern those individual decisions create after the fact. Less than a quarter of the financial executives we've worked with keep track of the total amount of negotiated discounts given. Almost none measure how these discounts are distributed across various customer segments and over time.

A survey we conducted a few years ago with Financial Executives International confirmed our observations about the software industry's tracking practices and sheds valuable light on the magnitude of price negotiations. (We do most of our work in the software industry, but much of what we present here will be useful to any company in which negotiated discounts are significant.)

Although few respondents had any hard historical data, they guesstimated that their nego-

tiated discounts equaled 25% of their booked revenue, on average, and often exceeded 50%. If figures this large were to appear on a P&L statement, they would be subject to detailed analysis and executive-level control.

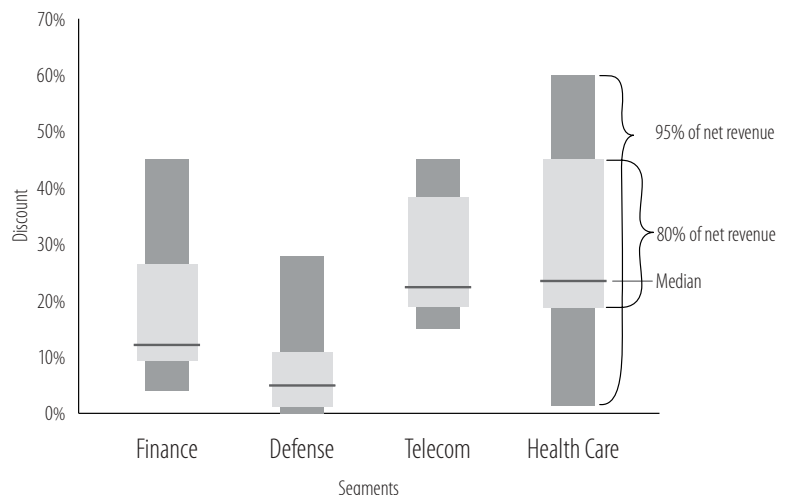
To cultivate discount awareness and discipline, managers should start by asking themselves the following questions:

- **Are discount dollars being invested in the customer segments and product categories that provide the greatest strategic value to the company?** For that to be so, discount guidelines for each segment and category need to be established in advance of negotiations.
- **Do discount levels associated with a particular customer segment or product category vary widely, beyond what can be attributed to differences in deal size?** If so, guidelines for determining discount size need to be set and enforced, and additional sales training may be appropriate.
- **Are discounts fairly consistent over time, or do they rise sharply at the end of the quarter?** Higher discounts at quarter's end are expected, as the sales team strives to hit targets. If these spikes are excessive, though, sales incentives may need to change, so that reps are re-

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Who's Getting Discounts?

With this dashboard view, a software company was able to compare at a glance the distribution of discounts within and across its market segments. For instance, in the health care segment, the median discount was 24%, 80% of the company's net revenue in that segment was brought in through deals whose discounts ranged from 19% to 45%, and 95% of net revenue was brought in with discounts ranging from 3% to 60%. Contrast that with the consistently lower discounts being granted in the defense sector or the tighter range of discounts in the telecom sector.



warded for keeping their discounts in line.

- **Is excessive discounting a widespread, relatively uniform problem in the company?** Such a pattern calls for a broad review of discount policies and a fresh look at price lists, which could require downward adjustment.

To answer these questions and monitor the discount landscape on an ongoing basis, companies can use two complementary techniques. A *discount dashboard* shows how negotiated discounts are distributed across customer segments or product categories, helping executives assess strategic fit. It also highlights how discounts vary within segments or categories. *Drill-down views* into discrete segments or categories reveal how discounts vary with deal size, so aberrant deals can be flagged and reviewed.

For example, a client who used a dashboard chart to assess discount variation across customer segments spotted a relatively high median level in the health care segment. This was troubling, since the company's health care solution was as good as the competition's. The dashboard also revealed an unusually broad spread of discounts within that segment, a finding that warranted further study. (See the exhibit "Who's Getting Discounts?" Please note that we have changed the segment names to protect the client's privacy.)

A drill-down view of the health care segment was then used to see whether the discounts there increased with deal size, as they

should. As the exhibit "Do the Discounts Make Sense?" shows, they did not. In fact, no clear pattern emerged. To investigate further, the client had two more dashboard views of the health care segment prepared, one that broke discounts down by sales rep and another that broke them down month by month. The first view revealed the problem: A small number of reps had negotiated a large share of the high-discount deals. Those reps were made aware of how their discounting performance compared with their peers', and they were given supplemental training on the value of the client's health care solution.

Deciding among the many ways to achieve discount discipline is a critical and sometimes difficult task. Very often, executives and managers take too broad an approach. With the methodology described and illustrated here, they can see precisely where the problems lie and take highly targeted action.

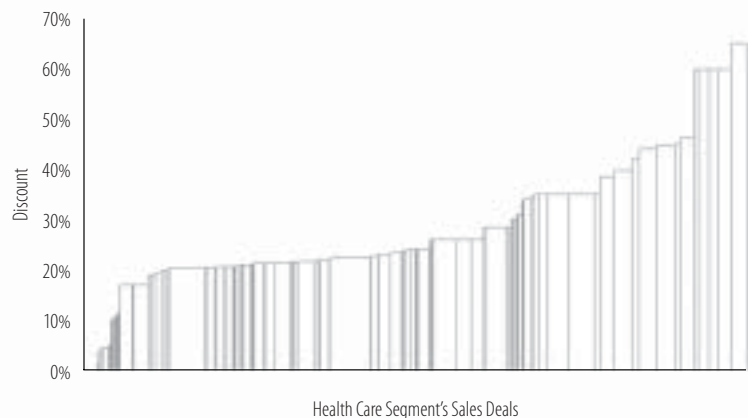
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Do the Discounts Make Sense?

This drill-down view of the health care segment described above helped the company assess whether discounts increased in accordance with deal size, as they should. Each bar represents one deal: The width shows the size of the deal; the height shows the discount given. In a company exercising discount discipline, the higher the discount, the wider the bar should be. That is clearly not the case here.





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