

Manage Negotiated Discounts to Control and Increase Revenues and Profitability

In our software pricing practice, clients often ask us to help them set new prices so they can increase revenues. Often these calls concern new product pricing (and very late in the launch cycle.) Unfortunately, new products do not have an immediate impact on revenues since it takes a while before they are a significant fraction of sales. Even massive price changes to existing products take 6-9 months before they affect revenues as the new prices flow through the sales pipeline.

However, Marketshare has found a way to affect revenues very quickly -- within 3-6 months or sooner.

Our method for helping clients get an immediate revenue boost is to exploit a source of untapped revenue -- large deal discounts. To be sure, companies will always negotiate discounts to get orders from large accounts. However, we find that much more money can flow to the company if deals are structured and negotiated properly and discount schedules are more carefully constructed.

In many cases, one-third to one-half of the negotiated discount can be recovered and converted into revenue. Any money recovered from these discounts increases the top line and drops directly to the pre-tax line of the P and L.

Pre-tax profitability rates can increase by 20 percent or more...

For example, we estimated that one client would increase their earnings per share by \$0.02 for every 1% decrease in large deal discounts. This technical software company was letting their salesforce give up \$0.10 or \$0.20 per share in order to do business with their large customers.

Profits Slip Away in the Typical “Big Deal Process” with Large Customers.

Profitability often suffers during “Big Deal” negotiations with customers. The process looks like this:

- Rep presents initial proposal; Customer wants a better price.
- Sales rep re-configures deliverables and recalculates prices. Sales rep submits final version of the sales proposal.
- Customer considers the revised proposal which includes
 - List of products*
 - Price of products net of standard volume discounts*
- Customer and sales rep negotiate the final price. (Typically, the customer does this more often than the sales rep putting rep at great disadvantage.)

- At some point, the customer wants the rep to “do better” before they will sign the contract. Sales rep closes the deal by ...
 - ... *“throwing in” more product keeping price the same or;*
 - ... *giving customer more discount for same product deliverables or;*
 - ... *throwing in more product and giving up more discount*

The results: Customer gets better price; rep gets commission; company loses margin.

How Management Can Avoid Losing Margin Unnecessarily

While every company knows the invoiced amount of the deal, in an informal survey of more than 100 software sales and marketing executives, less than one-third said their software companies tracked the spread between invoiced amount and the amount net of standard discounts. This is important when the sales rep gives up additional product or additional discount -- sometimes both -- to get the sale.

Companies that track this spread -- “give ups” (as in how much the sales rep “gives up” to get the deal) will know how much money was left on the table and know how much revenue can be recovered.

By tracking give-ups, management can answer the following questions:

- How do “give up” amounts vary across deals of similar size? Of similar product content? For similar customers?
- Why is there a variance in the amount of “give up” for different divisions of corporate accounts? Why do some sales reps give up less discount than others?
- How much do we give up to get customers take delivery sooner? As we approach the end of the quarter or fiscal year?
- Are the negotiated discounts large relative to standard corporate discounts or standard volume discounts? Should our standard discounts be changed?
- By how much would our market capitalization change if we could recapture 5% of the negotiated discounts?

With this information, sales management can choose a course of action:

- Train certain sales reps to negotiate more carefully
- Provide added management support to reps involved with specific accounts
- Consider changes to sales incentives programs pertaining to discounts

The amount of discount control and revenue management can be applied flexibly -- from specific accounts or reps all the way out to across the board implementation.

The Bottom Line: Managing Profitability, Increasing Net Worth

Decreasing negotiated discounts can have a significant affect on profitability rates and stock valuation.

For reference, the financial impact of leaving less money on the table is described in the attached table. The data is based on a typical software company described in the Financial Operating Ratios For Software Companies Report 1996-1997 published by Culpepper and Associates, Inc.

However, these financial benefits do not have to be one-time events.

By judiciously controlling and **managing** the negotiated discount amounts, management can more finely control their revenue and profitability.

Situation: *A development program that is running over budget in a quarter, or there are one time costs associated with an acquisition.* **Response:** *Decrease negotiated discounts in three new accounts and one existing account this quarter to offset these expenses*

Situation: *A large order comes in sooner than expected.* **Response:** *Increase the negotiated discount on selected accounts to provide added incentives and get the deal so sales will exceed plan next quarter (or as insurance against a large deal slipping by a quarter.)*

By managing negotiated discounts senior management is in a position to more finely control company revenue and profitability. By doing so, the financial performance of the company is more predictable which leads, in the case of public companies, to increased earnings and stock prices.

For privately held companies, the benefits are even greater as the bulk of the increased valuation flows to a limited number of shareholders.

For more information about whether your firm can benefit from the revenue enhancement/discount management program described above, contact Jim Geisman, President of Marketshare (jim@softwarepricing.com) for a confidential assessment of your situation.

Revenue and Valuation Impact
of Leaving Less Money on the Table
(Typical Software Company)

Total Revenues	100%	
Net income	6.5%	
License revenues only	60%	% Total revenues
Big deal revenues	30%	50% license revenues
Negotiated discounts	12 %	Big deals get 40% discounts
Amount recovered	3 - 6 %	Recover 25-50% of negotiated discount
Percentage improvement		
Revenues	3 - 6%	Revenues and pre-tax increase by 3-6 percentage points
Pre-tax income	46 - 92%	
Impact on valuation/ market cap (% increase)		
Based on X Revenues	5 - 10%	Market Cap = 2-3X Sales
Based on X Earnings	4 - 7%	Market Cap = 15-20X Earnings