

LIBEY ON STRATEGY

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Welcome to the first issue of Libey On Strategy, a monthly e-newsletter written by Don Libey, published and distributed by MeritDirect as a service for its clients. Each issue will explore a strategic element of the direct marketing future and its influence on your profitability and corporate valuation. Libey On Strategy is a new publication in addition to Libey's Multichannel Advisor, also published and distributed by MeritDirect.

The New Price Strategy

You will be faced with a demand for new and changed price strategies in the immediate future. Some say the Age of Consumption is over and that we will never return to the pre-Great Recession levels of spending in the U.S. and, indeed, much of the world. Others say it is the "New Normal" reflecting the pushing of the global economic Reset Button. And, there are others who see the current period of deflation and softening prices as only a temporary response. I have heard thoughtful individuals say, "It's just an adjustment, so adjust and get on with it." I'm not convinced it is that simple. I would offer a discussion that considers whether we are faced with an entirely new pricing strategy for the future, one that has as its core element permanently reduced contribution to overhead and net profit.

Migration of the Market

The merchant's loss of control of the selling event which shifted to the consumer during the emergence of the Internet is likely to never be reclaimed. The consumer has choices and has learned to use those choices for their constant advantage. For all of its expansion potentials, the Internet has re-educated buyers in the process of consumption. As a result, the merchant has lost control of the selling proposition.

With the concurrent emergence of the "net-gnats" (a term I coined in the early 1990s), the consumer found another type of merchant ready to bargain and discount to obtain a few crumbs around the edges of commerce and to take one or two points of market share to the eternal irritation of the established merchant class.

With the market migrating out of the merchant's control, the inevitable pressure point was on prices. For well over twenty years we have had a primary pricing strategy of discounting exacerbated in the recent decade with free shipping offers. No matter how one attempts to justify such an environment for selling, the end result is always margin erosion and the end result of margin erosion is almost always reduced profits.

The Evidence

The beginnings of the current pricing model were clear with the growth of Wal-Mart years ago. In the late 1990s my DVD *The Wal-Martization of America* (produced by *DMNews*) argued that the only possible consequence of Wal-Mart's national expansion was margin erosion for the direct marketing world. Wal-Mart's "everyday low prices" was the first push of the "reset button."

Others contributed to the price strategy change. Amazon.com spent most of the 1990s and all of the 2000s redefining price and the concept of competitive store fronts. The outcome gave the consumer even more control, albeit in a centralized store model. Zero-financing paved the way for the demise of the profits of the auto industry beginning in 2001. Even McDonald's caved in with their "Dollar Meals" as the bait for market growth. Couple "stand-on-your-head" price strategy over a twenty year period with the Great Recession and loss of millions of jobs in the mid- to late-2000s and the outlook for pricing recovery is bleak if not permanently deranged. The American consumer is simply not likely to be buying high margin products in the future.

The market basket of goods shows prices dropping. The same market basket shows a shift from "Best" products to "Better" products and, increasingly, to "Good" or even "Okay" products. A \$3.25 pair of safety glasses seems to do the job as well as an \$8.99 pair of safety glasses, at least in the mind of the buyer.

Corporate travel is redefining acceptable prices. Hotel room rates have dropped by nearly 30 percent from the highs of 2006. The necessity for travel is being redefined, as well. As a result, conferences and seminars are experiencing significant reductions in attendance, in effect a price reaction. The Consumer Price Index posted its biggest decline since 1950, a 2.1 percent annual drop in July of 2009 and is not really moving much.

The Chain of Consequence

Seventy percent of the U.S. economy is driven by consumer spending. When the consumer has absolute control, ever-lowering prices create a "wait and save" mentality. The more expectations are for lower prices, the longer the buyers wait to purchase until those prices, in fact, are lower. Producers, retailers and distributors, in turn, are forced to cut costs during that "deflation/stagnation" period. That causes erosion of profits leading to lay-offs, hiring freezes, and wage reductions. The employment erosion causes less consumer consumption and the spiral continues its destruction.

Great Recessions like the one we have recently experienced come rarely, only every 60 to 75 years. But, their effects are very long-lived. Japan has been in a deflationary spiral for over 20 years, and it is not improving. It takes decades to make up lost ground. The last Great Recession, the Great Depression of 1929, was only resolved by the economic demands of World War II and did not end until 1953, nearly 25 years later.

The Chain of Consequence is forged by price strategy. Currently, many of the world's largest consumer and business-to-business companies are announcing price cuts, or at

least price stability. They are betting they can gain volume and, at the same time, take even more out on the cost and overhead side. The outcome is unknown, but the strategic direction is absolutely clear: Value Pricing. I believe it is a dangerous, short-sighted strategy. Do not attempt to beat the First Law of Marketing: *In the beginning, there must be margin.*

So What Do We Do?

First, good strategic planning will consider the importance of a strong program of new product development. New products that resonate with the customers are the best hedge against deflation and margin erosion. However, good new products must create an advantage for the customer, either in convenience, problem-solving, efficiencies, effectiveness or, last, cost. A product that solves problems and saves money is a much better product than one that is simply priced lower. New products that also create a new market or rejuvenate a maturing market are equally critical to strategic success.

Perhaps never before has there been such a need for radical new product concepts and innovation as there is at this point in our commercial history. It is clear to me that we cannot recover based on discounting and that the only potential for recovery will come from product innovation and problem-solving applications that create immediate value for the customer—*preferred value.*

I would offer that the correct strategy for long term growth and security is one that is new product intensive. I would further offer that it takes precedence over channel development strategies. And, I would go so far as to say that you are likely sufficiently advanced enough in online, social media, PPC, and the other e-commerce technologies that are soaking up most of your dwindling resources, that you can now focus your intense concentration and financial commitment to the essential strategy of new and innovative product development and preferred value as a customer perception.

You can survive the "Channel Battle" or you can survive the "Price Battle" or you can win the "New Product War." By winning the war, you are assured of winning the battles.

There is a caveat, however. By New Product War I do not mean more of the same products, nor do I mean 'long tail' concepts. I mean in-depth, well-researched, customer-driven new products that assist your customers in reducing costs, processes, and overhead. Those are the products that are compelling and that must be purchased. That is preferred value. That is where you want to go. You are in need of a full new product revolution, an entirely new way of looking at the products your customers need and may not know they need. This is more than a strategy; this is a crusade to own your niche market through product intelligence, not discounting.

You begin with a full product audit that includes life-cycle analyses, price-point analyses, obsolescence analyses, and all of the classic product evaluations. From there (knowing where you are relative to the existing products), you undertake an exhaustive customer audit of product needs. Once you are inside the heads and the financials of your customers and understand their product applications, you shift to a collaborative approach

with those customers to new product applications and development; in effect, you and your customers create the new product innovations in the living laboratories of their companies. You then source the new products, apply sales forecasting tools, analyze the financial parameters, and begin the merchandising strategy planning to bring the products to market. If all goes well, you will have reinvented your company for another incarnation of its existence. And, if all goes well, you will have leap-frogged the price strategy requirement of the New Normal Economy and you will have market dominance and leadership for the future.

The Take-Away

The new economic reality is not simply a price adjustment reality; rather it is a product utility reality. Your products must transcend pricing strategies if you are to emerge in a dominant market position with margin. Your products must have a level of innovation such that they offer your customers undeniable and essential *utility* when they are purchased. Your customers must look to you for products that improve their earnings. If you can develop that level of product innovation, you will be free from the shackles of discounting and free from minor competitors who have a severely limited product vision forever stuck in the 1990s and the 2000s.

The degree of focus you give to this strategic imperative will determine the extent of improved customer counts, sales volume, contribution to overhead, earnings and corporate evaluation.

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