

Article 19 – King Canuting

I had a boss once who used the phrase “King Canuting” to signal the refusal of his management team to face up to reality. It was of course a reference to King Canute, the Danish King who ruled England, Norway and Denmark in the same century as the defeat of King Harold by William the Conqueror.

Legend has it that he was carried down to the water’s edge on his throne at low tide so he could demonstrate to his courtiers his omnipotence even over the forces of nature. The truth, apparently, is somewhat different but never let the facts get in the way of a good story.

One aspect of business that is particularly susceptible to King Canuting is pricing – specifically market pricing.

What I mean by market pricing is that band of prices that moves up and down according to the laws of supply and demand. If demand for a product exceeds supply, the market price will rise and if supply exceeds demand, the market price will fall. Market prices have only a very tenuous connection to costs and contrary to popular wisdom, they apply equally to commodities and brain surgeons. It’s just that in the case of brain surgeons, demand traditionally exceeds supply.

I refer to it as a band of prices simply because there is never one going market price. Some suppliers, being different and better than their competitors can command a premium over the median price, whilst those that lack the resources to achieve this sell below the market price. In between are the majority who cannot command a premium but are not reduced to selling at a discount. These companies are frequently regarded by their customers as “just another supplier” with no apparent competitive edge of any sort.

One group that is particularly vulnerable to the vagaries of market pricing is those companies that rely on one off projects and bid for those projects via a tendering process.

The problem is this. The tender is put together so that it meets internal financial guidelines. The guidelines used are the same as for previous successful bids. The price is likely to be 10% higher than other competing bids but all previous indications are that your company can command a premium. When the tender evaluations are completed, you are told that your tender was not successful. It was 20% higher than the winning bid and whilst your company’s reputation was taken into account, the gap between your price and the winning bid was simply too great to justify on the basis of superior value for money. You later discover that the successful tenderer has spare capacity and was pretty desperate to win the business even if the margins were slim.

You then have to make a judgement call. Do you do a King Canute and ignore the experience, treating it as a one-off aberration or does your loss signal a long-term adjustment in the market price?

Some long-term reductions in the market price can trigger enormous changes and there is no better example than the car industry.

Right up to the early 80’s Mercedes had an unsurpassed reputation for quality and engineering excellence – “Engineered like no other car” as their ads constantly reminded us. What’s more, their reputation allowed them to sell cars at a massive premium over others of lesser quality and this masked the essential weakness in

their production process. They inspected poor quality out, which was OK until the Japanese started to match their quality by building good quality in. Then, when the Japanese started to challenge Mercedes directly with the Lexus and others, the Company could no longer do a King Canute. It could still sell cars at a premium using the Mercedes brand image but it had to totally rethink its production philosophy and re-engineer its production processes in order to compete in a global market at the new market prices.

If you believe that the band of market prices in your market is trending downwards and the movement is permanent, what do you do about it? Probably the last thing you want to do is to damage your ability to charge a premium so slashing costs is not usually the answer. Rather the aim should be to increase efficiencies and hence productivity – so the end product or service is the same or better but the cost base is less.

I recall an article on the history of manufacturing in which the author identified four eras over the last hundred years or so.

Rollsism – craft production

Fordism – mass production of cheap units

Mercedesism – quality low volume production

Toyotism – differentiated mass production with lean, quality orientated systems, characterised by Just-in-time, Total Quality Control, or more generally, Kaizen (continuous improvement)

You don't have to be a car manufacturer or even a manufacturer of any kind to see some parallels between the above and your company.

I came across the modern equivalent of the story of King Canute the other day. It was in a flier for a seminar on "Pricing optimisation" and on the front page was a quote attributed to Will Rogers. "Even if you're on the right track you'll get run over if you just sit there".

Graham Haines
September 2005