MFL The Pricing Times

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Opportunity Knocks – Raise Your Prices Now!

Increasing prices is a lot of work and poses real risks if not well managed and executed. To us, however, a solid strategy and process for price increases not only offsets rising input costs, but also creates a quiet mechanism to close price leaks, improve customer/product mix, and strengthen position with sweet spot accounts. In light of the rapid increase in the cost of most raw materials over the past 6 months (oil just hit $100, $110, $99, ?), now is the time to raise prices. **Don't wait.**

Businesses that are good at raising prices follow four steps to maximize return and minimize risk:

1. Get the hard facts about your situation **today.**
2. Decide and document your short- and long-term pricing goals.
3. Develop specific pricing tactics for every account - including price level, timing, and communications.
4. Productively manage communications to all audiences.

1. Get the Facts

Start by capturing detailed facts about: first your customers, second your competitors, third your raw materials, and finally your own business. Businesses usually prioritize and collect information in the reverse of this order and then run out of time to gain a solid understanding of their customers and competitors. Although every business will have a different, important set of data to collect, each business should cover the same common sense topics.

Customer Information

Understanding the impact that you have on your customers' businesses should be a first order issue. For example, what percent of your customers' costs do your products represent, how has that changed in the past 2 years? Are your customers' price moves to their customers ahead or behind relative to your prices moves? How do the customers stack up relative to their competitors? In addition, understanding how each customer is performing relative to their own profit, share, and growth goals and metrics can provide great insight into the pressures customers are facing to cut or raise their prices and to fight price increases from suppliers.

Pricing tactics should also consider what each account knows about your raw materials prices and what is happening to their other major raw materials. Most importantly, the price change approach should consider a factual understanding of your customers' switching costs (the expense, time, capital, and risk involved in either changing to one of your competitors, or changing to an alternative solution). Finally, the price communication approach may be impacted by how your customer may have changed their buying process or their internal metrics in response to their current uncertain and unstable environment.

Competitor Information

Finding and documenting information about your competitors is a sound business practice at any time. In the current environment, however, it is even more important to track your competitors to gather specific details about their costs, goals, and strategies so you can anticipate their actions and reactions. For example, are your competitors' raw material costs changing in the same way and at the same time that your raw material costs are changing? If not, what impact will that have on their reaction to your pricing actions? Also, do you or they have a cost advantage in procuring raw material?

It is equally important to understand when and how your competitors have changed their prices over the past 2 years and specifically what they have said - not only broadly to the market, but also to each one of your accounts. Their communication strategy should provide insight into whether or not they are now going to limit price increases to try to gain share or drive hard increases to build margins. And, of course, it is important to understand how competitors' sweet spots line up with your sweet spots. Competitors will defend theirs more aggressively than they will attack yours. Finally, understanding a competitor's ownership and incentive plans can provide unique insight as to when and how they may be changing their prices.

Input Cost Information

There is no question that every business carefully tracks its own input component costs. It is also useful, however, to track the current and expected supply demand balance for critical components to understand the pressures driving the prices in the markets, not just what we are paying for components today. Suppliers' profit levels, growth expectations, and public announcements can reveal the pressures they are under and help predict their actions. In this environment, some material prices are not increasing because suppliers are restarting significant capacity. In these situations, you may find that your overall raw material prices are not increasing despite the fact that some of component costs are going up very rapidly. Another important factor impacting your own component supply situation is a clear understanding of your switching costs relative to alternative suppliers and/or alternative components.

Company Information

The final pieces of information needed to determine price increase strategy are fact-based insights about your own situation. A powerful analytical tool is to create a curve showing the level and timing of changes in your cost of materials over the past 2 years compared to the changes in your product prices over the past 2 years by account. This analysis allows you to understand, quantify, and easily communicate whether you are ahead or behind in total dollars. With these data you can present a persuasive case to customers about your need to increase prices until you have recouped your lost margins and at the same time make the point that you have protected them from the full impact you have seen in raw material cost increases.

Understanding exactly what has been said to individual accounts at the time that you have made price changes cannot be given too much priority. Surprisingly, many businesses don't document what their sales force tells accounts as a way to understand accounts' expectations are on a go-forward basis. Many companies find themselves trapped by what they told customers about recent price changes. If they have raised price strictly because of an increase in a specific raw material, like oil, they have likely lost negotiating power by creating an expectation that when the price of oil goes down, their prices will come down. Companies that have implemented fuel surcharges or raw materials surcharges are especially subject to this loss of power relative to their customers.

2. Set Your Pricing Goals

Too often we see businesses drive price increases strictly from an internal perspective without considering all the audiences that will be impacted by, and react to, price changes. In addition, each internal function in a business can have significant impact on the successful implementation of pricing actions. Success, therefore, requires agreement from the full management team on short- and long-term pricing goals before specific pricing decisions are made and actions taken. Four factors drive price change goals:

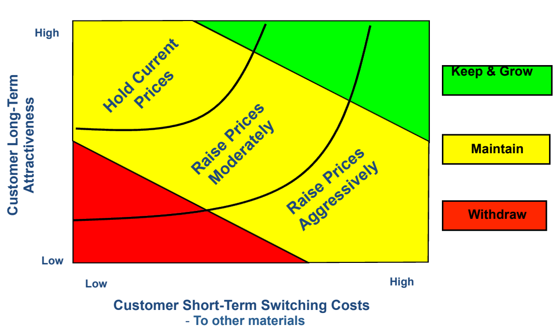
1. How much impact you want and expect to have on your customers' growth and profitability
2. What perception you are trying to create in each of your external audiences (shareholders, customers, banks, competitors, and suppliers)
3. What changes you expect to make in your market share and mix relative to competition
4. And finally, goals for short- and long-term top line and margin dollars.

3. Develop Detailed Tactics

One of the toughest challenges in pricing is avoiding making across the board moves - increasing prices the same amount on all products to all customers at the same time. Across the board price actions are easy to implement, but nearly always are wrong for every customer; too much, too soon; too little, too late; or some combination of each. Organizations avoid this challenge because it is hard and time consuming work to analyze each individual piece of business and make a definitive decision on when and how much to change price and how to describe that change to customers. The return on this investment, however, is typically far greater than any other use of the organization's time and energy.

The chart below illustrates how one company analyzed and segmented individual pieces of business to determine where, when, and how to change prices. Every business needs to develop its own segmentation dimensions. The ones shown (customer long-term attractiveness versus customer short-term switching cost), however, have proven to be powerful and useful segmentation dimensions for a number of businesses.

Pricing segmentation approaches can be used to determine price change strategies



With the pricing goals and analyses in hand, your organization can develop an account-by-account plan for the amount of price increase and the timing of price change relative to; competitor actions, customer demands, supplier actions, or your current inventory and cost situation. Finally, account-by-account data will help determine what messages you want to deliver to each target audience and how you want to manage the communication so that the messages are productively delivered.

4 . Productively Communicate Price

Communicating price increases productively requires a disciplined communication strategy that explicitly specifies: the message content, the people in your organization to write and deliver the message, the media (email, hard letter, phone call and/or personal visit), and the timing to deliver the message to each part of the customer's organization. Each portion of the communications strategy needs a responsible leader and the organization should have a formal system and process to ensure timely completion of each step.
The negotiating tactics used by sales are obviously key to successful implementation of an increase. One technique we find has power is to plan to offer a possible quid pro quo as part of the negotiation to reduce the amount of price increase. These could range from closing a price leak – e.g., eliminating cash terms or consigned stock, to an opportunity to acquire additional pieces of business.

Despite the challenges we face during these uncertain times, investing to productively manage prices in an increasing raw material price environment should have a very high management priority. Virtually every company can improve margins and solidify their market position over the short- and long-term by careful account-by-account price management with the right information effectively communicated to the right audiences.

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MFL's Consulting practice focuses on helping our clients build margins and volume by capturing their fair share of the value they deliver to their customers. We have found that pricing, while often managed in isolation, can be a powerful and integrating lever to drive a necessary shift in mindset and capability.

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