THE PRICING TIMES

March 2008

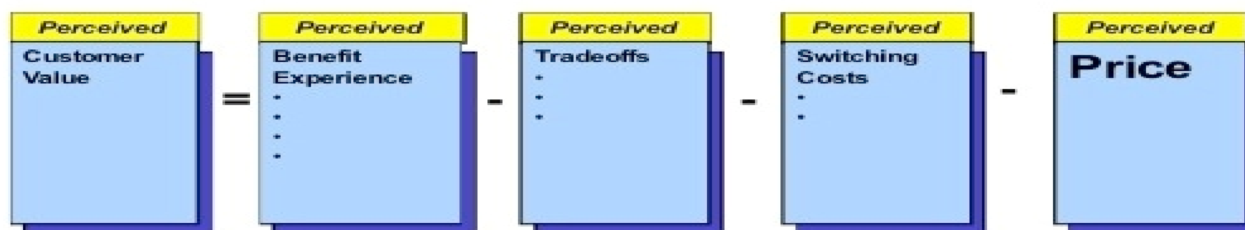
Are you contributing to inflation in 2008? If not, why not!

Raising Prices: Never Easy, But Done Right, Very Possible and Very Profitable

Raising prices to enhance margins while not reducing share or volume is an ongoing leadership challenge - one that many businesses handle poorly. This is true despite pressures from rising costs of materials, transportation, and labor.

Business leaders who understand the elements of the Value Equation consistently and successfully increase prices and margins, even in commodity-like businesses. Steve Jobs is a good example. He knows that a key to success in increasing price is to increase perceived benefits or reduce trade-offs at the time of a price change. His recently introduced I-Tunes store pricing for unprotected (without digital rights management – DRM) songs is 30% higher than standard downloads ($1.29 vs. $.99). Customers benefit by receiving a reduced tradeoff (no DRM). However, Jobs also added a significant benefit by doubling the sound quality of downloads. As a result, he was able to command a significantly higher price and margin and likely pick up volume and protect his share in the download music market. On the industrial side, Parker Hannifin achieved dramatic and sustainable profit gains by examining prices on every one of over 800,000 parts and selectively increasing prices on most of them.

Price is implicitly linked to perceived value in the customer's mind



Parker's approach was driven by segmenting their markets based on the benefit levels and distinctiveness (competitive intensity) of each application. They implemented price changes ranging from reductions for a few low-value products with multiple competitors to well over a 25% increase for high value products only available from Parker.

They then made the investment to assign a pricing specialist to lead and sustain this effort in every one of their 115 divisions. As a result, Parker added over $200M of annual net income from improved pricing. In both examples, management's understanding of the Value Equation from their customers' perspective was the key to success.

Customers combine their perceptions of benefits, tradeoffs, their cost to switch to an alternative, and their ability to pass on their increased costs to either accept or reject a price increase. In both industrial and consumer markets the key to building positive perceptions – and achieving successful price increases - is managing not only the level of price change, but also, the timing and communications of the price change on a very detailed – often on an account by account -basis.

Too many business leaders have made the common, but unrecognized mistakes of implementing a simple, across the board increase, timing the increase to fit their own budget and planning process, while ineffectively communicating new prices to customers. They followed this relatively unsuccessful path because they viewed price changes from the inside out, rather than from their customers' perspective-in. An outside-in view of a business as supported by the Value Equation, shows that it is unlikely that the benefits received and perceived by 2 different customers are exactly the same. Hence, it is unlikely that an across the board price increase will have the same "right" level and timing for any 2 segments or individual customers. The extra effort needed to differentially raise price nearly always pays off.

Improving benefits or reducing tradeoffs are obvious actions to link to price increases to help build a positive perception and reception. Less obvious, but often equally important, is selecting the right timing to communicate and implement price increases. Too often businesses make the price increase timing decision based strictly on internal factors – e.g., raw material cost increases or budget shortfalls. The likelihood of price increase acceptance is much higher if a customer's own considerations support or drive the timing decision. These considerations could include their buying process metrics, budget cycle, and their ability to capture price increases for their own business.

A customer's recognition of the driver for a price increase along with their ability to pass it on, with solid justification to their customers, has a significant impact on price increase yields. Linking your price increase timing to the timing of a very visible and important cost component – e.g. an oil price increase or publically discussed increased in prices of other major inputs– typically reduces rejection and smoothes the way for more frequent and higher price increases. This is because customers can use the same visible and public information to help increase their prices and avoid suffering reduced margins (and unfavorable performance metrics) Unfortunately, many companies don't initiate their own price increases until their systems report the negative impact on their costs and margins, typically months after the publically visible event.

In sum, linking increases in benefits (or reductions in tradeoffs), timing and communicating price changes to match customer's internal budget cycles or price windows or to coincide with visible external events, can minimize the negative impact on a customer's internal performance metrics easing the task of gaining acceptance and achieving improved price increase yield while minimizing the risk of volume or share decline.

Achieving successful price increases starts with understanding the customers' value equation and ends with understanding their buying process and selling process. Shifting mindsets across your business to this outside-in perspective can enhance your ability to implement successful price increase actions leading to sustainably higher returns.

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The MFL Group One Chagrin Highlands 2000 Auburn Drive, Ste 300 Beachwood, Ohio 44122 * Elliot B. Ross ebr@mfl.com David J. Nuecheterlein djn@mfl.com * v. 216.514.3022 f. 216-245-1563