Price Management

Price increase management:

Successfully implement price increases

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Little brings management as much unease as the prospect of having to inform customers of a price increase. Yet, due to inflation and rising costs, price increases are not a luxury but rather a necessity in order to maintain a healthy business.

All too often in the face of adversity and doubt, price increases are delayed, insufficient or inexistent. In times of rising costs, the net result is a margin squeeze due to the company's own inability to act.

In order to assist companies make the right decisions when considering price increases, Simon-Kucher & Partners have conducted an online survey to benchmark the best management practices within the construction and chemical industries. 232 executives answered questions ranging from "To what extent is your business affected by fluctuating raw material prices?" to "Why couldn't the price increase be successfully implemented".

Combining the insights from the survey with over 25 years of pricing experience, we offer to share our framework for successful price increases.

88% of the companies implement price increases at least once a year

Experienced management professionals know that price is the strongest profit driver. Even a small increase in price can offset a drop in volume or rising costs. 70% of the companies state they are strongly affected by fluctuating raw material costs which put their margins under pressure. In response, 88% of the companies implement price increases at least once a year, most of which do so by up to 5%. Price increases are necessary to maintain healthy profits, yet 12% of companies surveyed fail to take active steps through pricing. Given that price is the profit driver with the strongest impact, any pricing mistake causes immense losses. And since 79% of respondents' companies place at the top 3 of their respective industry, failure to raise prices may trigger competitive responses which could negatively impact the entire industry.

Only 23% of the respondents manage to successfully increase prices

Although it is a reassuring thought that the large majority of businesses take the step of increasing prices regularly, how successful are they? As it turns out, not very! Only 23% of the respondents manage to successfully increase prices (success being defined as implementing at least 60% of the planned increase).

Two-thirds of respondents explain this staggering insight with external factors, and a third places the blame internally. Amongst the latter, the main reasons for failure are fear of volume loss either by sales or by management, and excessive exceptions granted to customers. Others point the finger at, unsurprisingly, competition, switching customers and over-capacity in the market. Although there are limits to what companies can do externally, addressing internal shortcomings should be a priority.

Successful managers do three things more consistently

What did those who were able to implement price increases do better? Successful managers do three things more consistently:

1. **Differentiate price increases**
   General price increases across the board are not the most effective way to prevent margin erosion. Instead, successful respondents use a value-oriented differentiation by products, by customer and by region. Segmenting the market according product and customer value, understanding the value-in-use for the application of products and services, as well as assessing price sensitivity are important tools in achieving a suitable differentiation for price increases.

2. **Target value and price argumentation**
   One of the major differences between successful managers and those who fail to implement price increases is the preparation of a strong storyline. By formulating clear argumentation guidelines, management is able to provide its sales force with the required tools for a convincing discussion with customers. Unfortunately, all too often communication is ill-prepared, and channels are ignored with only 12% of respondents communicating price increases through the media. Most importantly, a successful price increase is dependent on top management commitment. Management needs to be firm with the increase and back-up their sales force.

3. **Use alternative mechanisms to increase prices**
   Alternatives can be used to boost profitability. Of those who are successful in avoiding margin erosion, 47% use surcharges in addition to price increases. In sectors where costs are significantly subject to fluctuations, such as those dependent on raw materials, surcharges are an important aspect of profitability. 39% of successful respondents claim to have raised fees for services, while 44% consider scaling down discounts an effective method. These different approaches all increase the net price customers pay without changing the list price. Because companies should never forgo an opportunity to raise prices, these alternative mechanisms should be used in combination to a price increase. In practice, a company could for example announce a

3% general list price increase with a further 2% increase on service fees.

Following this framework will ensure a higher rate of success in implementing price increases

Price increases do not belong in the realm of chance, they must be prepared. In order to do so, managers should follow this 4-step approach.

Step 1 – Breakdown of price increase targets
Start by setting clear increase targets which must then be broken down into components. These could be value classes, regions, applications, products or customers depending on what is most relevant in terms of segmentation. After conducting a risk assessment, differentiate the increase for the appropriate segments consistently with the overall pricing strategy.

Step 2 – Preparation and conduct of price increase
Ensure that top management is fully committed to the price increase and that the sales force is sufficiently incentivised by price-success-dependent compensation. External communication is critical and the sales force are the company's voice. Prepare value argumentation guidelines and negotiation trainings to support customer communication.

Step 3 – Steering and monitoring the price increase
Exceptions and compromises dilute price increases and may ultimately lead to failure. Create transparency by setting up price parameters and establish processes and guidelines to monitor and control prices in order to help ensure a successful implementation.

Step 4 – Preparing plan B
Finally, run mock scenarios to assess risks and prepare a "plan B" and even a "plan C" as counter-measures. This extra step is an emblem of pricing excellence.

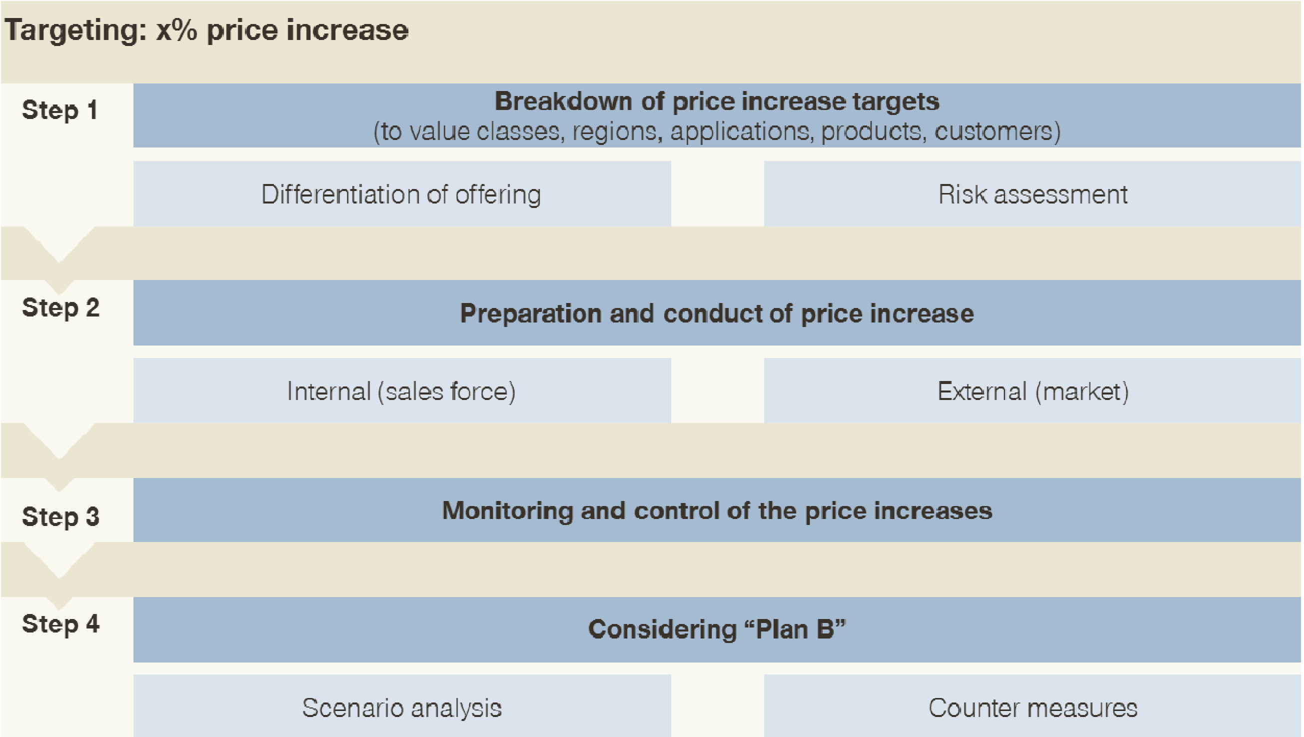

Figure 1. Simon-Kucher Price Increase Framework

With only 23% of companies capable of successfully implementing price increases, this framework responds to a clear need for change in practices.

Data source: Simon-Kucher & Partners, "Short study of price increases" online survey, 2013.

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Simon-Kucher & Partners, Strategy & Marketing Consultants is a global consulting firm with over 700 employees in 27 offices worldwide focusing on Smart Profit Growth[SM]. Founded in 1985, the company has almost 30 years of experience providing strategy and marketing consulting and is regarded as the world's leading pricing advisor.

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