Do You Really Have Pricing Power?

We all know that pricing power is one of the best predictors of a company’s long-term financial success and market growth, but how do you know if you have it? Pricing power is one of those things that is very easy to identify in retrospect, but significantly more difficult to proactively create. In this article, the author explores key questions businesses should ask themselves to determine how much pricing power they actually have. He specializes in driving the adoption of complex ideas and products by translating customer insights into tangible value. Patrick McCullough is Director at Holden Advisors. He can be reached at pmccullough@holdenadvisors.com.

Investors have long heralded pricing power as one of the best predictors of a company’s long-term financial success. Warren Buffett’s famous quote from 2010 captures the sentiment.

“The single most important decision in evaluating a business is pricing power. If you’ve got the power to raise prices without losing business to a competitor, you’ve got a very good business. And if you have to have a prayer session before raising the price by 10 percent, then you’ve got a terrible business.”

However, the simplicity of this statement doesn’t reveal the complexity of pricing power; how to know when you have it, how to build it, and how to use it effectively.

Let’s have a look at some key questions to get started on your way to true pricing power.

Do you have pricing power?

Jack Welch was once quoted as saying, “Any idiot can raise prices,” and he was right. For most in competitive markets, if the price is too high, it will result in the failure to achieve desired sales volumes when customers either find a suitable alternative or choose not to purchase at all.

However, there are many instances in which a suitable alternative or even a competitor doesn’t exist. Let’s use Martin Shkreli as an example; do you think he had pricing power when he raised the price of a 62-year-old drug 5,000%? If you think your product is a commodity, do you see an opportunity to build pricing power?

Key Question: Is your product or service commonly sold at a discount?

If the answer is ‘yes’, you either lack pricing power, have the wrong offering structure, or both.

Can you build pricing power?

Pricing power isn’t just about raising prices. It’s about matching the value you deliver to the price customers pay for your products or services. So yes, you can build pricing power when you create a situation in which customers believe they receive more value from your product or service than the price they pay.

However, what happens when customer needs and expectations change? How long will your pricing power last?

The flow of information and the speed of innovation intensify competition and continually change the playing field. Jeff Bezos famously said, “your margin is my opportunity” demonstrating Amazon’s, along with many other companies’, interest in driving market disruption. What do you do?

Key Question: How well do you know your customers and can you segment them into groups that have similar value needs?

The increased availability of information not only empowers customers to learn more about their options, but also empowers companies to learn more about their customers. You may, in fact, have pricing power in certain cohorts of your customer base that you haven’t identified or do not understand.

Long-term vs short term pricing power:

A few weeks ago, a friend in the investment industry sent me an interesting article: “Pricing Power: Delighting Customers vs. Mortgaging Your Moat.” In the article, a distinction is drawn between companies who use pricing power to delight their customers versus those who use it to exploit their customers. This distinction, between two different uses of pricing power, is very important and more subtle than you may think. Let’s look at the following scenario:

A raw materials supplier has the advantageous position of excess inventory in a time of market-wide shortages.

• Option A: The supplier who “delights” customers will use pricing power to create a tiered offering based on delivery lead times and allow their customers to choose the price they are willing to pay based on the speed at which they wish to receive their goods.

• Option B: The supplier who “exploits” customers will raise the price for the supplied item across the board, giving customers no choice but to pay the higher price.

Is there a right option? Consider the alignment of your commercial strategy to your corporate goals and identify the critical opportunities to drive both short and long-term profit growth.

Key Question: Why do your customers do business with you?

Customers always ask for a discount and most will continue asking. “Delighted customers” are those who have a choice and continue to choose you, time after time, despite holding your price.

The most important question to ask is do I really have pricing power? Pricing power is one of those things that is very easy to identify in retrospect, but significantly more difficult to proactively create. Why? Because you must continually scan the market, competitors, and customers to understand how your products and services provide impactful value and how it changes over time. Only then, will you be able to define an offering structure in which customers feel they are receiving greater value than the price they pay.

You may not “have a prayer session” before each price increase as Warren Buffett joked, but I encourage you to dig deeper into each of your unique customer cohorts to better understand the value they perceive/receive from your products and services.
Price Increase? No Problem. Preparation Beats Price Pressure

Many companies are forced to pass on increased costs to maintain their own revenues. However, a recent online Simon-Kucher survey on price increases revealed that only 17% implement their price increases successfully. Why is this? In this article, author Nina Scharwenka discusses how to beat price pressure and successfully implement price increases. The key to success lies in the preparation. Nina Scharwenka is a Partner in the Global Consumer & Retail Practice at Simon-Kucher in Munich. Apart from classical retail and FMCG business, she focuses on the luxury/watches, apparel, cosmetics, tobacco and sports industries. She can be reached at Nina.Scharwenka@simon-kucher.com.

Price hikes. A delicate topic that companies prefer to avoid. You don’t get anything if you don’t ask for it, and in recent years, nobody had to ask. However, higher prices for raw materials, inflation, and new environmental regulations are reversing the trend. Cost increases will make their way to customers’ wallets, one way or another.

Why is it so difficult to raise prices? A recent online Simon-Kucher survey on price increases revealed that only 17% implement their price increases successfully. Have companies simply forgotten how to increase a price?

Increasing prices for a product or service can be uncomfortable. But with the right preparation, it is definitely possible! Here are five steps for companies to successfully prepare for and implement price increases.

1. Know your power: Assess the current relationship

Reflect on actual business context to identify your strategic advantages. Your current relationship with the customer will play a role in the success of the planned price increase. Have price increases been successfully executed in the past? What were the typical challenges and what can you learn from them? Also consider when your contract allows for the next price increase and keep an eye on your Terms and Conditions! Your conditions system may need adjusting to prevent high discounts from cancelling out the effect of your price increases. And increasing price could even open up an opportunity to save on discounts.

2. Know the impact: Assess potential loss

Companies often avoid price increases due to a fear of losing market share. That’s why it is important to conduct an impact analysis beforehand. Start by looking at your history of introducing price increases with this customer. What were the reasons for success or failure? What can be learned from this previous experience? Diff-

3. Know your negotiation range: Define your walk-away price

Successful price increase negotiations require clear goals and guidelines. So before entering price negotiations, it is important to clearly define your entry and walk-away price points. Know where you have room to maneuver, and when you should stop or escalate. You will also need an intelligent set of bargaining chips at the ready. Develop a list of potential price and non-price related concessions in advance. These should be prioritized according to the value to the customer and your company. Finally, consider the different purchasers who may be involved in the negotiation. What are their seniority levels and histories? Map out scenarios in a decision tree that quickly identifies the different negotiation techniques to use with different negotiating partners.

4. Know your story: Stay confident with convincing communication

One of the biggest fails with pricing increases is that no specific reasons are given to the customer. With some luck on your side, that might fly with, say, a 2% increase. But higher increases definitely need justification. Rather than leave success to chance, it is essential to create a powerful story around your price increases before communicating them. Understand your customer’s supply chain to ensure your story is consistent, concise, and customer-specific. Start with the main benefits your company offers to the customer and focus on value, not just on cost. For example: the service quality, reliability, limited availability, product improvements that save time or make the product easier to handle. Frequently refer to factors surrounding the upcoming increases in all communication, e.g. calls.

Take a closer look and you will find preparation beats price pressure.

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by Nina Scharwenka
letters, and customer visits.

5. Know your strategy: Motivate sales with the right targets

In the end, it is your sales reps who will need to counter the objections from customers. Equip your reps with materials that support your compelling story, e.g. a negotiation roadmap, argumentation guidelines, and battlecards. Set clear price implementation targets, build confidence through training, and monitor your sales reps closely. Last but not least, management has to take a clear stand. Sales should not be scared to lose customers or business through price increases. Consistent communication from the top is essential to avoid conflict between price and volume targets. And the sales team should be able to celebrate the success of price increases too. Make sure the compensation model is modified to reward price increases, and that rebellious reps are held accountable for price deviations. It’s about switching the mindset from volume to value.

Unable to increase your prices? It is easy to blame price pressure. The competition is lowering their prices. The market is not accepting increases right now. We know the excuses all too well. Take a closer look and you might find you are standing in your own way. Don’t let poor preparation and compromises in negotiations derail your price increases. In the battle for profits, preparation beats price pressure. Look at your past price increase experiences, contractual agreements, and terms and conditions to determine your bargaining power. Define how far you are willing to go in the negotiations, consider counter offers, and use communication to prepare customers for price increases. And remember: only talk about costs if you can also talk about value! ✤