KEYNOTE INTERVIEW

Getting the price right

Setting the right price can have clear benefits for a portfolio company's bottom line, but only if the strategy is seen through to delivery and advocacy can be created within portfolio companies, says Pearson Ham's Tim Ham

Pricing is well established as a worthwhile avenue to pursue to create value in private equity-backed companies. Over the last 18 months, the covid-19 pandemic has had an uneven impact on different industries, placing even greater scrutiny on pricing. Here, Tim Ham, founder and chief executive officer of specialist pricing consultancy Pearson Ham, tells *Private Equity International* why clear pricing has never been so important.

Q What do you observe about pricing in private equity-backed companies when you first talk to them?

We see a wide range of challenges when it comes to pricing in the portfolio. Smaller companies have often neglected the subject of pricing, because they have simply not had enough bandwidth or lack a pricing department and as a result pricing is part of a broader function like sales or product development. In those cases, pricing is not getting the focus it requires and the challenge is to help management understand the opportunities they are missing out on. Very often a pricing opportunity exists because you are pricing too low, but management is unaware of the opportunity, there are organisational biases against moving prices, and because customers will not tell you your prices are too low.

At the larger end of the spectrum, we see companies with established pricing functions that have much more specific issues. They will be clear on the opportunity and looking for help in targeted areas, which is typically around price optimisation. That might involve getting a pricing structure in place, using pricing to drive performance improvements, or being more strategic and looking at commercial models, which is what we are seeing a lot of now in software and subscription-based companies.

Q How has the pandemic affected the pricing environment?

Covid-19 has impacted different markets in dramatically different ways, so there is no single theme. In some markets, we have seen cost increases creating a need for price rises, and here companies need to be clearer than ever on the rationale for what they are doing because increasing prices in the current climate is risky. There are also businesses that have benefitted from exponential volume increases but where a return to a normal trading environment will make these short lived. It is therefore important to manage and prepare for this volume reduction.

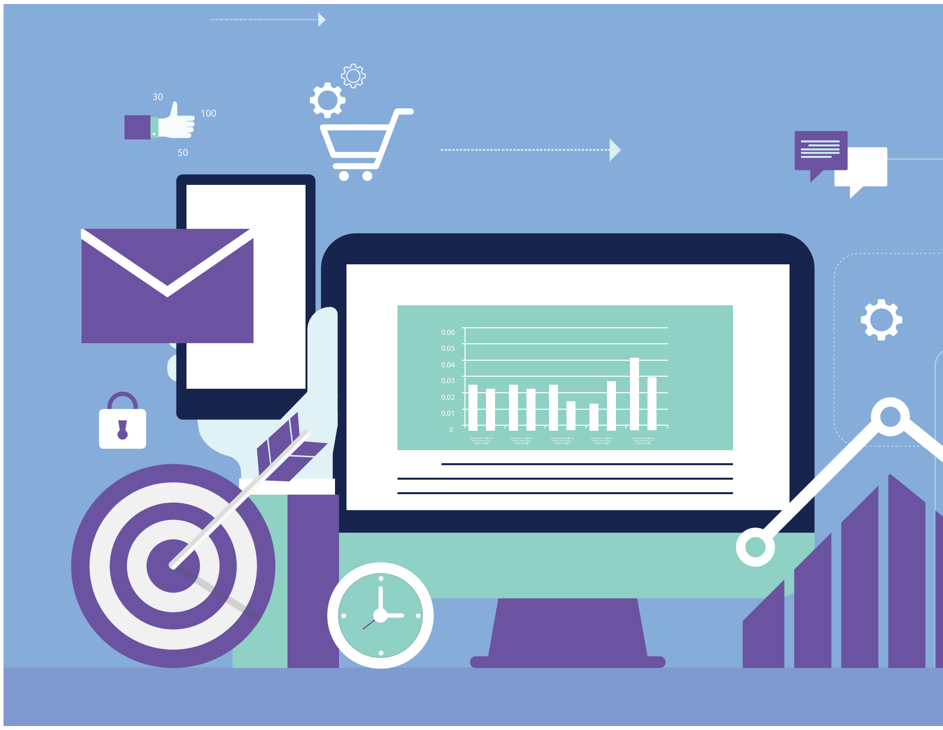
Across the market, the scrutiny with which people are examining price has driven a need for companies to be more upfront and clearer with customers about what they are doing, and why. If someone thinks a company is doing something cynically, they are going to react much more harshly today than in a normal environment. Raising prices because of cost increases is acceptable but the company needs to provide that rationale to their customer base.

In other markets that have been hit by covid-19 and where sales forces have struggled, we have seen real challenges with maintaining price levels and this then creates ongoing margin issues for the coming years.

Then there are markets such as motor insurance where costs have gone down, and we have seen prices being reduced due to lower mileage and fewer claims. Another example is private schools, where the inability to deliver the usual service because of the pandemic has led to customers questioning why they should be paying the normal fees for virtual learning and what they should pay longer term, again creating a need for careful explanation.

There are B2B situations where cost pressures on customers have driven increased scrutiny of the services they are purchasing, leading service providers to look again at commercial models and structure those in a way that protects them against reduced volumes.

> *"Companies often have a natural tendency to under-price"*



Q What is the potential upside of delivering pricing improvements in private equity? What are the drivers of those improvements?

Price optimisation, which focuses on moving prices within the existing price structure, is one of those areas. This typically leads to a 2-5 percent upside in margins, equating to \$20 million-\$50 million upside in a company with \$1 billion revenues. More strategic pricing opportunities can yield even higher margin upsides.

Companies often have a natural tendency to under-price, and that generally occurs for two reasons. First, they do not appreciate they are doing it, and second, there are psychological biases that occur. This is well documented and there are many factors driving it, from risk aversion to a bias in the communications from customers.

It is important to give clients comprehensive, robust and accurate insights about the market to help them better understand it. There is also often an element of market heterogeneity, and companies struggle to modify their pricing structures to reflect variations in their context, namely customers, products or channels.

Then, we often find there is a more strategic area where companies' commercial models can be adapted or evolved. Pricing and product agendas may not be sufficiently integrated. In software, we see developments being made in isolation without sufficient integration with the pricing and broader commercial agenda, often leading to missed revenue opportunities.

Finally, at the other extreme there are tactical elements about how you execute pricing through the sales force. How do you make sure your team has the skills to up-sell, that they fully understand the value proposition, can defend price objections from customers and explain the basis for price moves?

Q What trends are you observing in the evolution of commercial models?

Q What are your top tips for making pricing projects successful and capturing value through improved pricing?

I have seven tips to share, the **first** of which is around executive focus – pricing is important and deserves senior executive attention. Have a monthly session to review performance and the pricing agenda.

Second, respect the risk of bias. Most organisations overestimate price elasticities and under-price. Reflect on what is driving your assumptions and whether you are vulnerable to bias.

Third, gather external insights – do customer market research, run price tests or analysis of past price moves to establish price elasticities and counter these biases. These insights are crucial in gaining internal support.

Fourth, model choices. This involves creating scenarios, modelling them out and comparing the results. Judge price moves based on the predicted impacts not on a sense of what price moves feel comfortable.

Fifth, be strategic – pricing is not just about price levels and discounting. It is also about your value proposition, how you package your products, how you charge for them and the choices you present to customers.

Next, recognise emotions. Recognise that pricing is not just an analytical exercise. Behavioural biases apply even in B2B – value and fairness are crucial, and so is the story you tell internally and externally.

Finally, don't declare victory too soon. Implementation is everything and where the greatest risk lies. Take the time to plan this out, employ tactics and stay focused until success has been delivered.

Some of these trends are well understood – we see an evolution from product to service, which has been going on for decades, where it is increasingly possible to differentiate your product by augmenting your service. There is also a shift from upfront payment to subscription payment models that is well understood, in cars for example. We also see a need for businesses to move from cost-based commercial models to value-based models, which better align how value is extracted and how the customer realises value.

There are trends in disaggregation, particularly in markets where there are price comparison websites. We see companies taking their products and paring them down to the cheapest form and then upselling additional products or services, which occurs in sectors such as insurance, energy and air travel.

There are trends around product packaging and creating options and versions at different price points. There are also shifts towards performance-based payments, associated with service level agreements.

The common thread is that commercial models are better aligning value creation and value realisation. A commercial model that does this better is invariably a more successful one.

Q When do pricing projects go well, and why?

Projects go well in private equity when we have strong support from the private equity house, a strong mandate, and the ability to work closely with the management team of the portfolio company. A successful project is not just about defining the right solution but about driving that through to implementation to make sure the benefits are realised. This works best when there is a well-established relationship of trust.

Pricing warrants focus on an ongoing basis of course, and the best client-consultancy relationships mirror this. Sometimes we are involved during due diligence, or soon after acquisition, but we can come in at any point. If a business is of sufficient scale, it should be thinking of a pricing partner and constantly challenging itself on that to drive improvements through pricing, though we do appreciate there are a lot of other priorities on the table.

Q What are the common issues and problems that affect pricing projects?

Our approach is to be very focused on outcomes, but sometimes consultants confuse being clever with being useful. The right answer only gets you so far. We believe it is very important to focus on implementation, collaboration and maintaining a flexible approach throughout a pricing project.

It is not just about identifying the optimal price, but making that happen, which means understanding the commercial and product realities, understanding the personalities involved, and often about making sure the sales team is properly equipped, as they are usually the ones tasked with delivery. ■